



# NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

## THESIS

**THE ELUSIVE CHINA-JAPAN-SOUTH KOREA FREE  
TRADE AGREEMENT**

by

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September 2015

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**THE ELUSIVE CHINA-JAPAN-SOUTH KOREA FREE TRADE AGREEMENT**

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Submitted in partial fulfillment of the  
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## **ABSTRACT**

East Asia has become a major hub for global trade. At the center of this East Asian factory are three nations—China, Japan, and South Korea—which have benefited the most economically. Yet, despite transnational value chains and the trilateral political cooperation that binds these nations, they have yet to conclude a trilateral free trade agreement (FTA).

Since 1999, the China-Japan-South Korea FTA has proved to be an elusive feat for these Northeast Asian neighbors. Historical and political animosities and popular mistrust seem to have a corrosive effect upon the trilateral relationship despite decades of political cooperation and economic interdependence. What explains the limited progress toward a China-Japan-South Korea FTA? This thesis tests four potential explanations for the trilateral FTA's current lack of progress: perceptions of the deal not being an economic priority, the power of influential domestic business interests negatively affected by the FTA, regional competition over China's growing domestic market, and regional political-historical animosities. Overall, this research concludes that Japan is the least willing participant to push for progress toward a trilateral FTA, and a lack of perception of the deal not being an economic priority is the strongest explanation.

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## **LIST OF ACRONYMS AND ABBREVIATIONS**

ABMI	Asian Bond Market Initiative
AEM	ASEAN Economic Ministers Meeting
AFC	Asian Financial Crisis
AMRO	APT Macroeconomic Research Office
ANZCERTA	Australia-New Zealand Closer Economic Agreement
APT	ASEAN plus Three
ASEAN	Association of Southeast Asian Nations
CAFTA	China-ASEAN FTA
CASS	Chinese Academy of Social Sciences
CCP	Chinese Communist Party
CEPEA	Comprehensive Economic Partnership for East Asia
CMI	Chiang Mai Initiative
CMIM	CMI Multilateralization
DSM	Dispute Settlement Mechanism
EAFTA	East Asia FTA
EAS	East Asia Summit
ECFA	Economic Cooperation Framework Agreement
ECSC	Economic Coal and Steel Community
EEC	European Economic Community
EHP	Early Harvest Program
EPA	Economic Partnership Agreement
FDI	Foreign Direct Investment
FKI	Federation of Korean Industries
FTA	Free Trade Agreement
FTAAP	Free Trade Area of the Asia-Pacific
GDP	Gross Domestic Product
GVC	Global Value Chain
IGO	Intergovernmental Organization

JBIC	Japan Bank for International Cooperation
JETRO	Japan External Trade Organization
KITA	Korean Industry Trade Association
KORUSFTA	Republic of Korea–U.S. FTA
KPL	Korean Peasant’s League
MAFF	Ministry of Agriculture, Forestry, and Fisheries of Japan
METI	Ministry of Economy, Trade, and Industry of Japan
MoFA	Ministry of Foreign Affairs of South Korea
MOFCOM	Ministry of Commerce of China
MoTIE	Ministry of Trade, Industry, and Energy of South Korea
NAFTA	North American FTA
NEA	Northeast Asian
PPP	Purchasing Power Parity
PRC	People’s Republic of China
RCEP	Regional Comprehensive Economic Partnership
SASAC	State-owned Assets Supervision and Administration Commission
SOE	State-owned Enterprises
TCS	Trilateral Cooperation Secretariat
TETM	Trilateral Economic and Trade Ministers’ Meeting
TNC	Transnational Corporation
TPP	Trans-Pacific Partnership
USTR	U.S. Trade Representative
WTO	World Trade Organization

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## I. INTRODUCTION

### A. WHAT EXPLAINS THE LIMITED PROGRESS TOWARD A CHINA-JAPAN-SOUTH KOREA FREE TRADE AGREEMENT?

East Asia has become a major hub for global trade. The region leads the global trend of free trade agreement (FTA)<sup>1</sup> formation with 71 FTAs—40% of the world's FTAs—currently signed into law since the creation of the World Trade Organization (WTO) in 1995.<sup>2</sup> In East Asia, no one FTA is the same. Every FTA can be placed along two spectrums concerning standards and participants. Low-standard FTAs merely reduce trade barriers for certain goods, whereas high-standard FTAs include both goods and services and are deeply integrative. In regard to participants involved, FTAs can be reciprocal agreements between just two states or may include entire regions.

Despite being major hubs for world trade, the three major economic powers of East Asia, China-Japan-South Korea, have yet to sign their own regional, multilateral FTA. Trilateral track-one executive and foreign ministry summits since 2008 have yet to produce a trilateral FTA. The research question underpinning this thesis is: what explains the limited progress toward a China-Japan-South Korea FTA?

This thesis tests four potential explanations for the trilateral FTA's current lack of progress: perceptions of the deal not being an economic priority, the power of influential domestic business interests negatively affected by the FTA, regional competition over China's growing domestic market, and regional political-historical animosities. Evidence for the trilateral FTA not being an economic priority is the strongest for China and Japan, while evidence for South Korea is inclusive. In regard to the explanation of domestic business interests, there is weak supporting evidence among all three countries. The third explanation of competition over the Chinese domestic market has weak evidence from Japan and South Korea, while evidence from China is inconclusive. The final explanation of regional political-historical animosities causing a lack of progress toward the trilateral

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<sup>1</sup> There are multiple terms for a FTA, such as preferential trade agreement (PTA) or a regional trade agreement (RTA). This proposal will use the term free trade agreement (FTA).

<sup>2</sup> World Trade Organization, "Regional Trade Agreements," *Regional Trade Agreements Information System (RTA-IS)*, accessed November 21, 2014, <http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx>.

FTA is not supported by the Chinese and Japanese evidence, but there is strong South Korean evidence. Overall, Japan is the least willing participant to push for progress toward a trilateral FTA, and a lack of perception of the deal not being an economic priority has the strongest evidence to support that explanation.

## **B. HOW IMPORTANT IS A TRILATERAL FTA IN NORTHEAST ASIA?**

The creation of a China-Japan-South Korea FTA would be a significant development not only among the Northeast Asian (NEA) states but also for the larger East Asia region and for the United States. This section will list some of the potential promises of a trilateral FTA as well as some significant implications of the failure to create a trilateral FTA.

A China-Japan-South Korea FTA would enable these three NEA countries to leverage their comparative advantages in production so as to benefit from an increase in their overall productivity and welfare. The combination of China's advantages in low-wage labor with Japanese and South Korean technology and higher value-added manufacturing would create a production juggernaut. The FTA would connect an estimated \$24.6 trillion of gross domestic product based on purchasing power parity (GDP-PPP) as compared to the E.U. with \$18.1 trillion and NAFTA with \$21.1 trillion.<sup>3</sup> A trilateral FTA would allow the Japanese economy (\$4.8 trillion GDP-PPP) and the South Korean economy (\$1.8 trillion GDP-PPP) to be plugged into the larger Chinese economy (\$18 trillion), which has overtaken the size of the United States economy (\$17.4 trillion) in terms of GDP-PPP.<sup>4</sup> The effect of a trilateral FTA would create a one-time increase of GDP by an estimated .3% for China, .37% for Japan, and 3.55% for South Korea.<sup>5</sup>

In regard to the East Asia region, a China-Japan-South Korea FTA would

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<sup>3</sup> \$24.6 trillion of GDP-PPP was determined as aggregate sum of GDP-PPP for China, Japan, and South Korea GDP-PPP for October 2014. International Monetary Fund, "IMF DataMapper," accessed October 28, 2014, <http://www.imf.org/external/datamapper/index.php>.

<sup>4</sup> GDP-PPP values as of October 2014. Ibid.

<sup>5</sup> A 2005 analysis by the Trilateral Research Project provides a joint estimation. Trilateral Cooperation Secretariat, "Free Trade Agreement," *2013 Trilateral Statistics*, accessed December 8, 2014, [http://www.tcs-asia.org/dnb/user/userpage.php?lpage=3\\_6\\_2\\_contents](http://www.tcs-asia.org/dnb/user/userpage.php?lpage=3_6_2_contents).

formally cement and deepen the economic interdependencies that have informally tied China-Japan-South Korea—hot economics despite cold politics. Creating deeper economic interdependence between China-Japan-South Korea is advantageous for the region because such ties promote peaceful interactions by making war more costly, which in turn increases regional stability.<sup>6</sup> War is made mutually more costly by the investments between countries. Japanese and South Korean foreign direct investment (FDI) creates factories and jobs in China, while China uses such investment to acquire new technology and relies on the other two countries as markets for its products. Through the WTO, multilateral investment agreements, and an eventual FTA, China-Japan-South Korea can create a relationship of complex interdependence in which multiple contacts between state and non-state actors coupled with no one issue dominating any state's agenda can drastically reduce the probability of military conflict.<sup>7</sup>

Yet, if China-Japan-South Korea fail to lock themselves into a trilateral FTA, then the three states risk the potential breakdown of the current status quo of hot economics and cold politics (*zhengleng jingre* or *seirei keinetsu*), which has so far mediated relations.<sup>8</sup> Business commentators have recently opined on this risk as levels of FDI and trade has dropped off between China-Japan-South Korea.<sup>9</sup> In regard to Sino-Japanese relations, the recent weakening of Sino-Japanese economic interdependence is a potentially dangerous situation in that economic interdependence “can be ‘war-inducing’ instead of ‘peace-inducing’ if ‘states do not expect high levels of interdependence to continue.’”<sup>10</sup>

In the scenario of no trilateral FTA and cooling economics, the implications for the U.S. are serious. In light of security dilemmas and historical animosities, economic

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<sup>6</sup> John R. Oneal and Bruce Russett, *Triangulating Peace: Democracy, Interdependence, and International Organizations* (New York: W. W. Norton & Company, 2000), 155.

<sup>7</sup> Robert O. Keohane and Joseph S. Nye, *Power & Interdependence*, 4th edition (Boston: Pearson, 2011), 232–3.

<sup>8</sup> Dong Wang, “China-Japan Relations - Now What?,” PacNet (Honolulu, Hawaii: Pacific Forum CSIS, January 17, 2013), <http://csis.org/files/publication/Pac136.pdf>.

<sup>9</sup> Gordon G. Chang, “The Chinese And Japanese Economies Are Delinking: Prelude To Conflict?,” *Forbes*, February 16, 2014, <http://www.forbes.com/sites/gordonchang/2014/02/16/the-chinese-and-japanese-economies-are-delinking-prelude-to-conflict/>.

<sup>10</sup> Samuel Huntington quoted in Ibid.

interdependence would no longer serve as a mitigating variable among China-Japan-South Korea. American interests of preserving peace and stability in the Asia-Pacific region would become increasingly challenged by the ability of regionally divisive issues, such as the Senkaku Islands, East China Sea boundaries, and World War II grievances, to ratchet up Sino-Japanese tensions.<sup>11</sup>

Not concluding a trilateral FTA would also have the effect of adding more bilateral FTAs to the East Asian noodle bowl of trade agreements. Separate trade agreements among China-Japan-South Korea would not only complicate conducting business among the three, but also add to the cost of doing business. Foreign firms would have to untangle multiple rules that would add to the overhead cost of conducting business in China-Japan-South Korea. The risk for these states is that Western firms could become averse to doing business in Northeast Asia. American and European firms could end up directing their investment and technology to states that already have regional FTAs and are more conducive for globalized trade.

In regard to the American role in the region, not concluding a trilateral FTA can potentially serve U.S. interests by maintaining American influence and power in the region. A stalemate in NEA regional economic cooperation maintains the status-quo in East Asia in which the U.S. plays a pivotal role as both an economic and security provider. This status-quo is a form of hedging and balancing by Japan and South Korea in regard to Chinese power due to a perception of mistrust.<sup>12</sup> For the Japanese, China is to be balanced against by a policy combination of “dynamic defense” and “dynamic deterrence.”<sup>13</sup> For the South Koreans, the influence and power of China is hedged by “Seoul’s calculated strategic ambiguity.”<sup>14</sup> These policies are backstopped by the hub-and-spoke alliance system that binds Japan and South Korea to America. Any reduction

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<sup>11</sup> Office of the Secretary of Defense, “Quadrennial Defense Review 2014,” QDR (Washington, DC: U.S. Department of Defense, 2014), chap. 1.

<sup>12</sup> Jae Ho Chung, “East Asia Responds to the Rise of China: Patterns and Variations,” *Pacific Affairs* 82, no. 4 (2009): 657–75.

<sup>13</sup> Ken Jimbo, “The Rise of China and Japan’s Foreign Policy Reorientation,” in *China’s Power and Asian Security*, ed. Mingjiang Li and Kalyan M. Kemburi, 1st edition (Abingdon, Oxon; New York, NY: Routledge, 2014), 259.

<sup>14</sup> Jae Ho Chung, “Korean Views of Korea-China Relations: Evolving Perceptions and Upcoming Challenges,” *Asian Perspective* 36 (2012): 221.



of a perception of mistrust, such as binding trilateral FTA, reduces the utility of American regional involvement. The status-quo also compels China to accept American involvement in the region as a mediating force between itself and its NEA neighbors. While the Chinese may decry American influence in the region as a holdover from the Cold War, they do not deny that the American presence has utility in ensuring a peaceful environment for China.<sup>15</sup>

Conversely, a successful trilateral FTA could not necessarily be in the U.S. best interest in East Asia. Such an exclusive agreement among these NEA actors could possibly diminish the role and influence of American power in the region. For Japan and South Korea, enhanced cooperation and stability could reduce the utility of the U.S. hub-and-spoke alliance system in East Asia. A successful trilateral FTA could provide Japan and South Korea with a sense of assurance regarding Chinese foreign policy, which is often seen as aggressive. Essentially, a trilateral FTA could help change the regional environment so as to allow China, Japan, and South Korea to reassess their interests vis-à-vis the role of the U.S. in East Asia. In Robert Keohane's critique of balance of power, he asserts that "under different systemic conditions states will define their self-interests," and such conditions depend on whether or not the "environment is malign or benign."<sup>16</sup> The nature of the environment "can alter the standard operating procedures and sense of identity of the actors [states] themselves."<sup>17</sup> The cold politics in the region in which the U.S. has played a mediating role could change into a more benign environment that could lead China, Japan, and South Korea to identify their self-interests as not requiring the current level of American involvement in the region.

Overall, a trilateral FTA would have immense repercussions for China-Japan-South Korea, East Asia, and the United States. This chapter will outline the factors and causal mechanisms at play in regard to a trilateral FTA.

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<sup>15</sup> Peng Yuan, "Awaiting the Handshake: China-U.S. Relations Are the Key to Stability in Northeast Asia," *Global Asia* 6, no. 2 (2011): 34–37.

<sup>16</sup> Robert O. Keohane, *Neorealism and Its Critics* (New York: Columbia University Press, 1986), 194.

<sup>17</sup> *Ibid.*

### **C. CONTEXTUALIZING A CHINA-JAPAN-SOUTH KOREA FTA**

The literature review focuses on two particular literatures concerning China-Japan-South Korea economic cooperation toward a FTA: FTA formation and Northeast Asia (NEA) economic regionalism. This review will examine both literatures so as to draw out causal factors at various levels of analysis that shape China-Japan-South Korea economic cooperation. First, the review will divide FTA formation factors along the levels of analysis, and then put them into context of what types of FTAs have been created in the region as compared to elsewhere. Second, the literature on NEA economic regionalism will assess theoretical factors that encompass both state and non-state motivations as either forces that bind or separate NEA economic regionalism. Third, overarching factors that link both literatures will be identified in order to pose potential explanations in regard to the lack of progress toward a trilateral FTA, which will be drawn on for the rest of the thesis.

#### **1. Factors for FTA Formation**

The FTA formation factors provide a range of reasons for why China-Japan-South Korea would seek a trilateral FTA. These reasons include fostering state-led regionalism, expanding trade flows and efficiencies, competition over regional market-share and influence, and concerns over domestic politics. Each of these reasons affect the type and quality of FTA formed.

##### ***a. FTAs Used for State-Led Regionalism***

The formation of the European Union (E.U.) provides an example of previously antagonistic states that used high-quality FTAs to promote economic and political regionalism. In the European context, economic regionalism was and still remains a highly formalized state-led project. The roots of the E.U. were planted with the European Coal and Steel Community (ECSC) Treaty of 1951 that bound Western European countries together into an economic customs union. Despite being limited to certain economic sectors, ECSC created a multilateral, *de jure*, and independent supra-national bureaucracy that would evolve into a common market, the European Economic

Community (EEC), and then into its final form as an all-encompassing economic union.<sup>18</sup> The motivation for creating the ECSC was born from the trauma of two world wars that engulfed the European Continent. Leaders from France, Germany, and Britain internalized the importance of creating a binding regional institution that could mediate both economic and political regional factors.<sup>19</sup>

Yet, in the comparative literature of regionalism, there is disagreement as to whether a comparison to East Asia is possible.<sup>20</sup> The disagreement stems from the use of the E.U. as the definitive example of regionalism, which is related to the general criticism of applying European derived nation-state interaction patterns to East Asian states.<sup>21</sup> Criticism of applying the E.U. model to East Asia is that the E.U. is a *sui generis* case that cannot be applied outside of its context.<sup>22</sup> According to the criticism, the pattern of regionalization in Europe is specific to the continent-based interactions of Europe as opposed to the maritime interactions of East Asia.<sup>23</sup> Also, regionalism in NEA has been attributed to non-state forces that will be described in the regional factors section of this review. Despite such criticism, the example of the ECSC and the E.U. still remain relevant for examining the potential political-economic trajectory of China-Japan-South Korea.

### ***b. Trade Flows and Efficiencies***

A macroeconomic reason why nations form FTAs is because they are following prevailing trade flows and wish to increase both volume and efficiency of trade. This

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<sup>18</sup> Edward D. Mansfield and Helen V. Milner, *Votes, Vetoes, and the Political Economy of International Trade Agreements*, Kindle edition (Princeton University Press, 2012), Location 278.

<sup>19</sup> Mark Beeson, "Rethinking Regionalism: Europe and East Asia in Comparative Historical Perspective," *Journal of European Public Policy* 12, no. 6 (2005): 969–85, <http://dx.doi.org.libproxy.nps.edu/10.1080/13501760500270620>.

<sup>20</sup> Fredrik Soderbaum, "Theories of Regionalism," in *Routledge Handbook of Asian Regionalism*, ed. Mark Beeson and Richard Stubbs, 1st edition (Milton Park, Abingdon, Oxon ; New York, NY: Routledge, 2011), 11–21.

<sup>21</sup> Ibid., 15.

<sup>22</sup> Ibid.

<sup>23</sup> Ellen L. Frost, *Asia's New Regionalism* (Boulder, CO: Lynne Rienner Pub, 2008), 13.

follows from the idea that nations close in proximity will naturally come to conclude a trade deal.<sup>24</sup>

An efficiency explanation highlights how an FTA partner country can become more efficient in producing a certain product and entice others to enter into FTA negotiations. Initially, efficiency is achieved by an FTA partner state by the FTA's ability to harmonize and lower tariff rules as well opening economic sectors to competition through trade-liberalizing rules. As previously protected sectors are forced to compete, they must become efficient or collapse. The partner state's production efficiency has the follow-on effect of attracting other countries to negotiate separate FTAs with the efficient producer as well as direct FDI in order to utilize the comparative advantage of the efficient producer for the benefit of the investing state's transnational corporations (TNCs). The efficient producer state will agree to such FTAs because such agreements can maximize the amount of capital and foreign technology that can be received as well as increase levels of a state's welfare.<sup>25</sup>

**c. *International Factors***

FTAs can form as a means of projecting a nation's economic market-share in a desired region. This push factor is ascribed to the explosion of FTAs in East Asia.<sup>26</sup> Similar to states being driven by relative gains, states sign FTAs to lock in preferential trade patterns and influences that are in their favor. As one state seeks out FTAs, other states seek to establish similar guarantees in what Richard Baldwin calls the "domino effect."<sup>27</sup> In the domino scenario, states not involved in a regional bilateral FTA will seek to be included by proposing a regional trilateral FTA. This effect has been attributed to South Korean bilateral FTAs with the U.S. and E.U. that serve as an impetus for

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<sup>24</sup> Mireya Solís and Saori N. Katada, "Understanding East Asian Cross-Regionalism: An Analytical Framework," *Pacific Affairs* 80, no. 2 (July 1, 2007): 238.

<sup>25</sup> Ronald J. Wonnacott, "Free-Trade Agreements: For Better or Worse?," *The American Economic Review* 86, no. 2 (May 1, 1996): 62–64.

<sup>26</sup> Solís and Katada, "Understanding East Asian Cross-Regionalism," 232.

<sup>27</sup> Richard E. Baldwin, "The Causes of Regionalism," *World Economy* 20, no. 7 (November 1, 1997): 865–88, doi:10.1111/1467-9701.00107.

economic cooperation between China-Japan-South Korea.<sup>28</sup> Similarly, the formation of regional trade-blocs such as NAFTA and the E.U. can spur other states to sign FTAs with those bloc states so as to ensure the non-bloc state's market share is not diverted.<sup>29</sup>

Additionally, FTAs may be entered into as a form of economic diplomacy rather than for economic efficiency and utility.<sup>30</sup> Mirye Solis and Saori Katada attribute this desire as driving China to sign the China-ASEAN FTA (CAFTA) despite the fact that Chinese exports were already quickly overtaking those of the ASEAN states.<sup>31</sup> In this regard, CAFTA was signed in order to garner good-will between China and the ASEAN states.<sup>32</sup>

#### *d. Domestic Factors*

The impact of trade flows can have immense influence on national politics including "individuals' political beliefs, as well as on the political institutions they support."<sup>33</sup> By increasing overall social welfare and collecting electoral windfalls, FTAs create political incentives for national leaders and their ruling parties to ratify FTAs.<sup>34</sup> FTAs allows leaders and their political parties to "reassure the public and domestic groups about their decision making."<sup>35</sup>

Beside incumbent leaders and their political parties, there are other domestic factors that affect FTA formation. Government institutional players, business interest groups, non-governmental organizations, and civil-society groups can incur political

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<sup>28</sup> Gregory P. Corning, "Trade Regionalism in a Realist East Asia: Rival Visions and Competitive Bilateralism," *Asian Perspective* 35, no. 2 (2011): 259–86.

<sup>29</sup> Stephen Hoadley, "Southeast Asian Cross-Regional FTAs: Origins, Motives and Aims," *Pacific Affairs* 80, no. 2 (July 1, 2007): 303–25.

<sup>30</sup> Solis and Katada, "Understanding East Asian Cross-Regionalism," 248.

<sup>31</sup> *Ibid.*, 249.

<sup>32</sup> Guiguo Wang, "China's FTAs: Legal Characteristics and Implications," *The American Journal of International Law* 105, no. 3 (July 1, 2011): 495, doi:10.5305/amerjintlaw.105.3.0493.

<sup>33</sup> Mansfield and Milner, *Votes, Vetoes, and the Political Economy of International Trade Agreements*, Location 210.

<sup>34</sup> *Ibid.*, Location 805.

<sup>35</sup> *Ibid.*, Location 438.

costs if they view an FTA as not being in their interest.<sup>36</sup> Conversely, such players as the Japanese *Keidanren* (business federation) or the South Korean *Chaebol* (industrial conglomerates) can also promote FTA negotiation.<sup>37</sup> If an FTA is to be politically viable, the political benefits must outweigh the costs for incumbent leaders. This is not as simple as counting winners versus losers. Rather, what matters is which politically influential economic sector stands to lose. Domestic political structures that favor one economic sector over another can, intentional or unintentionally, act as chokepoints in the domestic political negotiations of an FTA. For instance, the Japanese agricultural sector, *norin-zoku*, is particularly influential because of its disproportionate electoral influence.<sup>38</sup> The *norin-zoku* created a sizable drag effect on former PM Junichiro Koizumi's ability to ratify many of Japan's FTAs.<sup>39</sup>

*e. Types and Patterns of NEA FTAs*

FTAs are not uniform as they can possess differing trade-liberalizing qualities. High quality FTAs produce agreements that liberalize trade beyond the current WTO multilateral agreements. Such "WTO-plus" agreements open up sectors to competition that have not been affected by the agreements reached during the WTO's Uruguay Round.<sup>40</sup> Low-quality FTAs are those agreements that merely lock-in unilateral tariff reductions and other previously established agreements.<sup>41</sup>

East Asian and developed Western economies have approached FTA formation differently. North American FTA (NAFTA), Australia-New Zealand Closer Economic

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<sup>36</sup> Guoyou Song and Wen Jin Yuan, "China's Free Trade Agreement Strategies," *The Washington Quarterly* 35, no. 4 (October 2012): 116, doi:10.1080/0163660X.2012.726425.

<sup>37</sup> Barry Desker, "In Defense of FTAs: From Purity to Pragmatism in East Asia," *The Pacific Review* 17, no. 1 (March 2004): 13, doi:10.1080/0951274042000182393.

<sup>38</sup> In Japan's electoral system, one rural vote count for five urban votes. See Isabel Reynolds and Maiko Takahashi, "Cities Set to Lose in Japan Election as Rural Voters Keep Clout," *Bloomberg*, November 26, 2014, <http://www.bloomberg.com/news/2014-11-26/court-rules-japan-2013-election-held-in-unconstitutional-state-.html>.

<sup>39</sup> Mansfield and Milner, *Votes, Vetoes, and the Political Economy of International Trade Agreements*, Location 1495.

<sup>40</sup> Razeen Sally, "Free Trade Agreements and the Prospects for Regional Integration in East Asia," *Asian Economic Policy Review* 1, no. 2 (December 2006): 308, doi:10.1111/j.1748-3131.2006.00036.x.

<sup>41</sup> Menon, "Preferential and Non-Preferential Approaches to Trade Liberalization in East Asia," 4.

Agreement (ANZCERTA), and the E.U. are examples of high-quality FTAs, as these arrangements include many WTO-plus issues other than tariff lines on traded goods.<sup>42</sup> Other than Singapore and Hong Kong SAR, the ASEAN states have been the leaders of producing “FTA-light” arrangements that maintain protectionist provisions rather than liberalizing reforms.<sup>43</sup> China uses a mix of high- and low-quality FTAs, but other than FTAs with Singapore and Hong Kong SAR, most of its FTAs in East Asia (e.g., CAFTA) are low quality. Chinese low-quality FTAs abound in East Asia because China is more concerned with garnering political credibility with ASEAN and neighboring states by deferring WTO-plus provisions on more sensitive sectors and services.<sup>44</sup> Japan and South Korea tend to produce stronger FTAs in the region as compared to ASEAN states and China, but Japanese and Korean FTAs are less liberalizing than U.S. or E.U. FTAs because Japan and Korea are generally opposed to opening their agricultural sectors.<sup>45</sup> The most comprehensive WTO-plus agreement currently in East Asia is the Republic of Korea–U.S. FTA (KORUSFTA) that went into effect in 2012.<sup>46</sup> Yet, even the KORUSFTA bent to heavy domestic Korean pressure to exclude their rice market from the agreement.<sup>47</sup>

## **2. NEA Economic Regionalism: The Forces that Bind**

There are various regional factors that push and pull on NEA economic cooperation. The regional factors provide both the context and theoretical motivation in which FTA formational reasons would have to operate. The regional factors are assessed

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<sup>42</sup> WTO-plus issues other than goods include: services, investment, labor movement, government procurement, trade facilitation, competition rules regulatory cooperation, and dispute settlement. *See* Sally, “Free Trade Agreements and the Prospects for Regional Integration in East Asia,” 308.

<sup>43</sup> Singapore and Hong Kong SAR are free-port economies and have a vested interest in creating high-quality FTAs that open other markets to their products and services. Also, these city-states do not have agricultural sectors, which are normally averse to liberalized trade deals. *See* Sally, “Free Trade Agreements and the Prospects for Regional Integration in East Asia,” 313.

<sup>44</sup> *Ibid.*, 309–312.

<sup>45</sup> Masahiro Kawai and Ganeshan Wignaraja, “Asian FTAs: Trends, Prospects, and Challenges,” *Asian Development Bank*, no. 226 (October 2010): 17–19.

<sup>46</sup> Jeffrey J. Schott, “Why the Korea–United States Free Trade Agreement Is a Big Deal,” *SERI Quarterly*, 2011, 23–29.

<sup>47</sup> *Ibid.*, 24.

are those that have acted equally upon China-Japan-South Korea, and include factors that both facilitate and prevent NEA economic cooperation. Factors that push cooperation include the GATT/WTO liberal trade architecture, ASEAN-driven regionalism, regional production ties, and state-led trilateral cooperation. Factors that pull at cooperation include conflicting identities, concerns over relative gains, and concerns over state sovereignty.

**a. GATT/WTO Architecture**

The post-World War II GATT/WTO multilateral trade architecture has provided influential institutional and economic norms that pervade through NEA regionalism.<sup>48</sup> This architecture provides mutually binding reduction of trade barriers and increased overall levels of trade by creating a standard set of rules, intergovernmental organizations (IGOs) that provide transparency, and dispute settlement mechanisms (DSMs) that treat all states equally.<sup>49</sup> This architecture provides a liberal institutional underpinning to NEA regionalism.<sup>50</sup> Specifically, the GATT/WTO architecture provides China-Japan-South Korea with self-satisfying interdependencies based on the current liberal trade system.

While the current global liberal trade regime has provided the common groundwork for interaction between China-Japan-South Korea, the WTO has been stymied in its efforts to advance a more liberalized multilateral trade standard since the initiation of the Doha Round in 2001. Unable to pursue global multilateral trade reform, East Asian states have continued with creating bilateral and multilateral regional FTAs, including initiatives such as the trilateral FTA, the Regional Comprehensive Economic Partnership (RCEP), the Trans-Pacific Partnership (TPP), and the Free Trade Area of the Asia-Pacific (FTAAP).<sup>51</sup>

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<sup>48</sup> Desker, “In Defence of FTAs,” 4.

<sup>49</sup> Heribert Dieter, “Trade Integration in Asia,” in *Routledge Handbook of Asian Regionalism*, ed. Mark Beeson and Richard Stubbs, 1st edition (Milton Park, Abingdon, Oxon; New York, NY: Routledge, 2011), 120.

<sup>50</sup> G. John Ikenberry, “The Rise of China, the United States, and the Future of the Liberal International Order,” in *Tangled Titans: The United States and China*, ed. David Shambaugh, 1st edition (Lanham, Md: Rowman & Littlefield Publishers, 2012), 54.

<sup>51</sup> See Christopher M. Dent, “Paths Ahead for East Asia and Asia-Pacific Regionalism,” *International Affairs* 89, no. 4 (July 1, 2013): 963–85, doi:10.1111/1468-2346.12054; Desker, “In Defence of FTAs.”



**b. ASEAN Driven Regionalism**

Although located outside the NEA region, ASEAN has become the center of regional economic cooperation in East Asia.<sup>52</sup> In regard to China-Japan-South Korea, ASEAN Plus Three (APT), an expansion of ASEAN that includes China-Japan-South Korea, has become an important institution that facilitates China-Japan-South Korea interaction across multiple governmental levels.<sup>53</sup> Yet agreements and instruments created by ASEAN and APT have proven limited in their utility.<sup>54</sup> ASEAN is also framed as being institutionally weak, and as being undercut by the competition between China and Japan for regional leadership.<sup>55</sup> While this competition has resulted in ASEAN becoming a hub for FTAs in the region, it is not seen as having sufficient power to serve as a regional leader for further East Asian cooperation.<sup>56</sup>

**c. Foreign Direct Investment, Transnational Corporations, and Global Value Chains**

Unlike the European experience of state-led regionalism, NEA economic regionalism has been guided by private business concerns that have tied the region together through links of investment and production. Specifically, Japanese FDI through transnational corporations (TNCs) has played a vital role in building industrial capacity in China.<sup>57</sup> The prominence of China in hosting Japanese FDI has steadily increased since the 1980s, and as of 2012, China overtook ASEAN as being the main recipient of

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<sup>52</sup> Jennifer Amyx, "Regional Financial Cooperation in East Asia since the Asian Financial Crisis," in *Crisis as Catalyst: Asia's Dynamic Political Economy*, ed. Andrew MacIntyre, T. J. Pempel, and John Ravenhill (Ithaca: Cornell University Press, 2008), 118.

<sup>53</sup> *Ibid.*, 120.

<sup>54</sup> Saori N. Katada, "Regional Financial Cooperation," in *Routledge Handbook of Asian Regionalism*, ed. Mark Beeson and Richard Stubbs, 1st edition (Milton Park, Abingdon, Oxon ; New York, NY: Routledge, 2011), 131–2.

<sup>55</sup> Frost, *Asia's New Regionalism*, 226–7.

<sup>56</sup> William T. Tow, ed., *Security Politics in the Asia-Pacific: A Regional-Global Nexus?*, 1st edition (Cambridge, UK; New York: Cambridge University Press, 2009), 1–2.

<sup>57</sup> Min Ye, "The Rise of China and East Asian Regionalism," in *Routledge Handbook of Asian Regionalism*, ed. Mark Beeson and Richard Stubbs, 1st edition (Milton Park, Abingdon, Oxon; New York, NY: Routledge, 2011), 253.

Japanese FDI in East Asia.<sup>58</sup> These FDI flows are immune to the oscillating levels of political hostility between China and Japan.<sup>59</sup> This immunity can be attributed to the desire of Japanese TNCs to leverage China's comparative advantage in low-wage production as well as to maintain and expand Japanese market share in a Chinese domestic economy of 1.3 billion people.<sup>60</sup>

Beyond maximizing efficiency and profit, consistent Japanese FDI into China can be attributed to complex interdependence that has developed between these two states.<sup>61</sup> Complex interdependence enmeshes states in a series of sensitivity and vulnerability interdependencies that constrain aggressive behavior.<sup>62</sup> Within in the context of complex interdependency, no one issue can stop economic interactions such as trade and investment.<sup>63</sup> Thus, FDI is an important signal of economic cooperation. FDI indicates economic cooperation because it shows the willingness of foreign investors to transfer capital and technology to boost economic production. In return, the host nation agrees to not expropriate foreign-affiliated firms and provide mechanisms for recourse in case of disputes.<sup>64</sup> Firms will then locate production points where products can be produced and transported efficiently along a global value chain (GVC).<sup>65</sup> As of 2013, GVCs accounted for 60% of gross world trade and 80% of gross world trade could be linked to GVC production networks.<sup>66</sup> Acting as the nexus between investment and trade, GVCs in East

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<sup>58</sup> Based on Japanese FDI data from UNTACD Bilateral FDI Statistics.  
<http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx>.

<sup>59</sup> Corning, "Trade Regionalism in a Realist East Asia," 269.

<sup>60</sup> Research Division, Policy, and Strategy, "Survey Report on Overseas Business Operations by Japanese Manufacturing Companies," Outlook for Japanese Foreign Direct Investment (Japan Bank for International Cooperation, November 2014), 23, <http://www.jbic.go.jp/en/information/press/press-2014/1128-32994>.

<sup>61</sup> Oneal and Russett, *Triangulating Peace*, 155.

<sup>62</sup> Keohane and Nye, *Power & Interdependence*, 232–3.

<sup>63</sup> Ibid., 20–1.

<sup>64</sup> Gregory P. Corning, "CJK Investment Agreements in East Asia: Building a Bifurcated Investment Regime," *Asian Politics & Policy* 6, no. 2 (2014): 286–8.

<sup>65</sup> OECD, "Global Value Chains," *Industry and Globalization*, accessed November 19, 2014, <http://www.oecd.org/industry/ind/global-value-chains.htm>.

<sup>66</sup> UNCTAD, *World Investment Report 2013: Global Value Chains: Investment and Trade for Development* (Geneva, Switzerland: United Nations, 2013), 135, <http://search.ebscohost.com/login.aspx?direct=true&scope=site&db=nlebk&db=nlabk&AN=664382>.

Asia have enmeshed states in production links in what is commonly called Factory Asia.<sup>67</sup> The implications of Factory Asia is that China-Japan-South Korea have developed linkages that requires each other to maintain complementary levels of economic well-being.

**d. *Trilateral Summits and China-Japan-South Korea FTA Negotiations***

China-Japan-South Korea Trilateral Summits have been the most recent manifestation of NEA regional cooperation. These meetings involve the participation of national chief executives and various ministers with the goal of increasing investment and trade as formalized under a China-Japan-South Korea FTA.<sup>68</sup> These summits created the Trilateral Cooperation Secretariat (TCS), which continues the dialogue beyond the track-one level of the Trilateral Summits and Trilateral Ministerial Meetings.

These trilateral forums, independent of ASEAN mediation, can be attributed to another facet of complex interdependence, multiple channels of contact.<sup>69</sup> Like the lack of hierarchy of issues, multiple channels of contact ensure that economic cooperation can continue.<sup>70</sup> Thus, even when track-one trilateral summitry comes to a dead-stop, as happened in 2013 due to political tensions over the East China Sea and Yasukuni Shrine, other venues such as the TCS and Trilateral Ministerial Meetings can continue the dialogue.<sup>71</sup>

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<sup>67</sup> Dieter, "Trade Integration in Asia," 117.

<sup>68</sup> See Prime Minister of Japan and His Cabinet, "Joint Press Conference by Prime Minister Taro Aso of Japan, Premier Wen Jiabao of the People's Republic of China, and President Lee Myung-Bak of the Republic of Korea Following the Japan-China-ROK Trilateral Summit Meeting," December 13, 2008, [http://japan.kantei.go.jp/asospeech/2008/12/13kaiken\\_e.html](http://japan.kantei.go.jp/asospeech/2008/12/13kaiken_e.html).

<sup>69</sup> Keohane and Nye, *Power & Interdependence*, 20–1.

<sup>70</sup> Ibid.

<sup>71</sup> The next round of FTA negotiations are scheduled for 23-29 Nov 2014. See "S. Korea to Hold Fresh Round of Talks for 3-Way FTA with Japan, China," *The Korea Times*, accessed November 25, 2014, [http://www.koreatimes.co.kr/www/news/nation/2014/11/116\\_168602.html](http://www.koreatimes.co.kr/www/news/nation/2014/11/116_168602.html).

### **3. NEA Economic Regionalism: The Forces that Separate**

While there are many factors that increase NEA economic regionalism, there are nearly as many factors that pull the region apart. These forces that separate are: conflicting identities, concerns over relative gains, and concerns over state sovereignty.

#### ***a. China-Japan-South Korea Identities***

Security concerns, territorial disputes, nationalism, and war history inform how these NEA states identify with each other as either partners or adversaries. For instance, South Korea let its FTA negotiations with Japan die on the vine in 2008 due to political and historical animosities and has yet to signal any interest in resuscitating that bilateral FTA.<sup>72</sup> How China-Japan-South Korea identify with each other are products of past interactions, and these socially constructed identities will drive future interactions so as to maintain those identities.<sup>73</sup> Constructivist thought suggests that identities drive interactions, so that “people act toward objects, including other actors, on the basis of the meanings that the objects [or actors] have for them.”<sup>74</sup> Memories of Japan during World War II inform regional perspectives of identity.<sup>75</sup> The acrimony that these identities produce create political impediments on issues such as trade and investment.<sup>76</sup>

#### ***b. Concerns over Relative Gains***

Realist concerns over relative economic gains is another force that pulls apart NEA regional economic cooperation. Relative gains drive states to “ask not ‘Will both of

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<sup>72</sup>Kevin J. Cooney and Alex Scarbrough, “Japan and South Korea: Can These Two Nations Work Together?” *Asian Affairs, an American Review* 35, no. 3 (Fall 2008): 177.

<sup>73</sup> Ted Hopf, “Identity Relations and the Sino-Soviet Split,” in *Measuring Identity: A Guide for Social Scientists*, ed. Yoshiko M. Herrera et al., 1st edition (Cambridge; New York: Cambridge University Press, 2009), 281.

<sup>74</sup> Alexander Wendt, “Anarchy Is What States Make of It: The Social Construction of Power Politics,” *International Organization* 46, no. 2 (April 1, 1992): 396–7.

<sup>75</sup> Thomas U. Berger, “The Politics of Memory in Japanese Foreign Relations,” in *Japan in International Politics: The Foreign Policies of an Adaptive State*, ed. Thomas U. Berger, Mike M. Mochizuki, and Jitsuo Tsuchiyama (Boulder: Lynne Rienner Pub, 2007), 179–211; Daniel Sneider, “Textbooks and Patriotic Education: Wartime Memory Formation in China and Japan,” *Asia-Pacific Review* 20, no. 1 (May 2013): 35–54, doi:10.1080/13439006.2013.793065.

<sup>76</sup> Ye, “The Rise of China and East Asian Regionalism,” 260–1.

us gain?’ but ‘who will gain more?’”<sup>77</sup> Within this framework, domestic differences that abound in the region matter little as states are primarily concerned with survival in regional hierarchical power relationships with an emphasis on relative power.<sup>78</sup> Since states are more inclined to balance rather than bandwagon,<sup>79</sup> strong states will seek to dominate other competitors for regional leadership by having a preponderance of power relative to others.<sup>80</sup> The implication of these concerns is that states will not enter into FTAs that disproportionately favors others. If one state receives more market share of a desired economy as a product of an FTA, then the other state will not agree unless it too receives a similar cut. Thus, the estimated spread of GDP gains of the proposed trilateral FTA—.3%, .37%, and 3.55% for China-Japan-South Korea, respectively—could serve as a point of contention between the three states.

*c. Concerns over State Sovereignty*

Another limiting factor toward greater NEA economic regionalism is that China-Japan-South Korea are state-centered and jealously guard all facets of state sovereignty.<sup>81</sup> The intense focus by East Asian states on sovereignty issues is due to both the unsettled nature of territorial dispute and post-colonial legacies.<sup>82</sup> Thus, China-Japan-South Korea have created political structures that control economic forces, the iron-triangle of politicians, bureaucrats and businessmen.<sup>83</sup> This has allowed certain economic sectors, such as agriculture in Japan and South Korea, to have disproportionate influence on decision makers. The implications of sensitive sovereignty are that NEA states are averse to accepting WTO-plus FTAs, which are perceived as degrading the autonomy of the

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<sup>77</sup> Kenneth N. Waltz, *Theory of International Politics* (New York: McGraw Hill, 1979), 105.

<sup>78</sup> John J. Mearsheimer, *The Tragedy of Great Power Politics*, Kindle edition (W. W. Norton & Company, 2014), Location 5596.

<sup>79</sup> Stephen M. Walt, “Alliance Formation and the Balance of World Power,” *International Security* 9, no. 4 (1985): 15, doi:10.2307/2538540.

<sup>80</sup> Mearsheimer, *The Tragedy of Great Power Politics*, Location 5615.

<sup>81</sup> Frost, *Asia’s New Regionalism*, 12–13.

<sup>82</sup> *Ibid.*, 13.

<sup>83</sup> Chalmers Johnson, “Political Institutions and Economic Performance: The Government-Business Relationship in Japan, South Korea, and Taiwan,” in *The Political Economy of the New Asian Industrialism*, ed. Frederic C. Deyo, 1st edition (Ithaca, NY: Cornell University Press, 1987), 136–64.

state. Therefore, a supra-national binding FTA in NEA, such as one that replicates ECSC standards and ties, would have to overcome immense institutional hurdles as well as deeply held beliefs about the role of the state. Of the three NEA states, only South Korea has shown that it is willing and capable of ratifying WTO-plus FTAs.

#### **D. POTENTIAL EXPLANATIONS: HYPOTHESES FOR A LACK OF PROGRESS TOWARD A TRILATERAL FTA**

There is a unique trajectory to China-Japan-South Korea economic cooperation that is guided by four overarching factors that tie together the literatures discussed above. First, trilateral economic cooperation is driven by private business concerns of efficiency and profit rather than state-led promotion of an E.U.-style regionalism. Specifically, TNC-driven FDI directed toward NEA global value chains provide both the glue and impetus for trilateral regionalism. Second, the political-economies of China-Japan-South Korea are highly influenced by certain economic sectors, such as agriculture, that weigh heavily on the internal bargaining process of FTA formation. Third, relative gains concerns influence the willingness of China-Japan-South Korea to cede market share for each other's TNCs. Fourth, China-Japan-South Korea political and security-driven animosities act as forces that constrain states from advancing NEA economic regionalism from ad-hoc production links to a politically formalized economic unit. These four overarching factors pose potential explanations in regards to the limited progress toward a trilateral FTA, as follows.

The first potential explanation is that if one of the three countries does not perceive a trilateral FTA as being an economic priority, then a trilateral FTA becomes less likely. Perception of the trilateral FTA as an economic priority depends on two factors. The first factor is whether or not China, Japan, and South Korea perceive minimal economic benefits from the trilateral FTA. The second factor involves the perceptions these countries have in regard to the economic benefits and feasibility of the other mega-FTAs, TPP and RCEP. Essentially, if any one of these countries perceives that TPP or RCEP provide more economic benefits than the trilateral FTA, and these other mega-FTAs seem to be a more feasible option, then the trilateral FTA will not be perceived as an economic priority.

The second potential explanation is that if influential domestic business interests are hurt by a China-Japan-South Korea FTA, then a trilateral FTA becomes less likely. If one singles out agricultural interests and assumes that China will always receive an agricultural output gain from a trilateral FTA, and that South Korean agriculture is no longer adverse to WTO-plus agreements, then the relative influence of Japanese agricultural interests can be identified as an important intermediate variable affecting FTA negotiation. For China, SOEs that are in sectors in which Japan and South Korea have a comparative advantage can also serve as an important intermediate variable affecting FTA negotiation.

A third potential explanation is that if China-Japan-South Korea are motivated by relative gains, then a trilateral FTA becomes less likely. This follows from Japan-South Korean competition over market share of a growing Chinese domestic economy. While both want greater access and reach into the Chinese domestic economy without ceding any influence, Japanese and South Korean policy makers potentially could be stuck in a relative gains dilemma. Thus, the expected economic windfall for South Korea as compared to Japan from a trilateral FTA could be viewed as a negative influence on Japan's willingness to cooperate.

The fourth potential explanation is that if China-Japan-South Korea antagonisms in politics and security increase, then a trilateral FTA becomes less likely. Specifically, Japanese management of its wartime history and territorial disputes in regard to domestic opinion in China and South Korea is a key intermediate variable.

Overall, these four explanations cover some of the more salient overarching factors that guide the trajectory of China-Japan-South Korea FTA and this thesis assess the relative causal strength of these explanations in understanding the elusiveness of the trilateral FTA.

## **E. RESEARCH DESIGN**

The research design will assess the empirical evidence for each of the four potential explanations. Afterward, this chapter will summarize the strength of the empirical evidence provided by this thesis.

The first potential explanation, that of a trilateral FTA as not being perceived as

an economic priority of one of the three countries, will be tested by determining whether or not TNC opinions concerning business operations in China-Japan-South Korea are averse to a trilateral FTA. In addition, how these groups and interests perceive the gains and viability of the other mega-FTAs will be assessed. If these private business opinions are averse to a trilateral FTA, then it can be predicted that such opinions should be reflected in economic and trade ministerial white papers and official statements, which have a vested interest in their national TNCs profitability.

The second potential explanation, protectionist domestic business interests, can be tested by assessing the political strength of the agricultural lobby in Japan and South Korea, which represents the most influential set of economic interests opposing a trilateral FTA. Evidence of such strength includes the agricultural lobby successfully ensuring the passage of crop subsidies, protective tariffs, and provisions to previously ratified FTAs. For China, SOEs in certain sectors that could be negatively affected by the trilateral FTA would also serve as potential lobby groups similar to the agricultural groups in Japan and South Korea.

The third potential explanation concerning relative gains over market share of the Chinese domestic economy can be tested by assessing Japanese-South Korean views of each other's TNCs competing over the Chinese market. If relative gains are a concern, then it can be predicted that Japanese-Korean trade and economic ministries should advocate positions concerning regional competition similar to that of their national TNCs.

The fourth potential explanation concerning China-Japan-South Korea political and security antagonisms can be tested by assessing whether or not these antagonisms affect the opinion of TNCs willingness to do business in on another's countries. If private businesses view antagonisms as critical impediments, then it can be predicted that these views should also be reflected in white papers and official statements of each other's trade and economic ministries.

## **F. SUMMARY OF FINDINGS**

This paper finds that Japan is the least willing participant to push for progress toward a trilateral FTA. Japan as well as China perceives the trilateral FTA as not an economic priority. The explanation that best accounts for a lack of progress on the South



Korean side of the negotiating table is that South Korea currently views historical and political animosities as a roadblock for further economic relations with Japan. The following four sections provide a summary of the strength of evidence for each of the potential explanations.

### **1. Strength of Evidence for Explanation 1: Not an Economic Priority**

There is strong evidence to show that the China-Japan-South Korea FTA is not a Japanese economic priority. Based on numerous statements and policy proposals, the largest and most influential business group in Japan, *Nippon Keidanren*, do not view the trilateral FTA as providing more potential economic benefits than that of TPP. Additionally, the *Keidanren* have primarily focused on ensuring that TPP negotiations progress so as to increase the viability of TPP. The *Keidanren* long-term view is that TPP is the best deal on the table, and that TPP can be used as the preferred benchmark to reach a future FTAAP-like agreement.

Japanese economic ministries and organizations, such as the Ministry of Economy, Trade, and Industry (METI) and the Japan External Trade Organization (JETRO), reflect similar opinions and strategies as the *Keidanren*. As expressed in METI and JETRO white papers, TPP is the gold standard of what an East Asian FTA can be whereas RCEP is a standard East Asian FTA. For METI and JETRO, the China-Japan-South Korea FTA is framed as a potential pathway to RCEP, but not as providing any greater economic benefits or as being more feasible than RCEP.

While there is evidence to show that South Korea does not perceive the trilateral FTA as an economic priority, the strength of this evidence is of neutral weight. South Korean business groups, such as the Federation of Korean Industries (FKI) and the Korean International Trade Association (KITA), have voiced caution and concern for any potential FTA with Japan. Their pessimism, however, does not match the opinions of South Korean economic policy think tanks. In addition, none of South Korea's diplomatic and economic ministries have voiced similar concerns regarding an FTA with Japan as FKI and KITA. While the South Korean Ministry of Foreign Affairs (MoFA) and the Ministry of Trade, Industry, and Energy (MoTIE) have prioritized RCEP and TPP participation over the trilateral FTA, they have done so as part of South Korea's overall

FTA strategy to become a regional hub for the new mega-FTAs forming in the Asia-Pacific.

For China, there is strong evidence to support the explanation of the trilateral FTA as not being perceived as an economic priority for the PRC. Multiple Chinese economic policy experts have voiced the limited utility and feasibility of the China-Japan-South Korea FTA. Instead, these Chinese policy experts perceive greater opportunity from larger regional arrangements such as RCEP and TPP. Official PRC statements from the Ministry of Commerce (MOFCOM) have echoed similar perceptions. Chinese FTA policy seeks to create both economically and politically competitive mega-FTAs vis-à-vis recent American efforts in regard to TPP, RCEP—and the recently announced proposals for FTAAP—provides for such needs, while the trilateral FTA has lost such economic utility.

## **2. Strength of Evidence for Explanation 2: Negatively Affected Domestic Interests**

In Japan, domestic interest groups, such as the politically influential agricultural cooperative *JA-Zenchu*, are not necessarily opposed to a trilateral FTA. *JA-Zenchu* as well as the Japanese Ministry of Agriculture, Forestry, and Fisheries (MAFF) have common interests and have stated positions that align themselves toward being supportive of the trilateral FTA. This common position is prefaced on the assumption that China-Japan-South Korea FTA will contain agricultural carve-outs. Thus, interest groups such as *JA-Zenchu* and their political allies in MAFF see less threat from a trilateral FTA than from a potential WTO-plus TPP.

South Korean agricultural groups, while influential, are not a strong enough force to cause a lack of progress toward a trilateral FTA. Domestic agricultural interest groups such as the Korean Peasants League (KPL), have been effectively placated by South Korean pork barrel politics. KPL and similar groups are adeptly handled through key concessions by the South Korean government.

In regard to the PRC, Chinese automobile, chemical, and general machinery SOEs are not a strong enough force to cause a lack of progress toward a China-Japan-South

Korea FTA. SOE interest and influence seems to have been effectively controlled by the PRC in that the CCP decides which SOE sector gets protection rather than the other way around. Additionally, SOE interests slowing the FTA is contingent on the final configuration of the China-Japan-South Korea FTA as either a WTO-plus or not WTO plus agreement.

### **3. Strength of Evidence for Explanation 3: Competition over the Chinese Domestic Market**

As for Japanese TNCs perceiving a competitive threat from South Korean firms in the Chinese market, the perception of threat is not supported by the evidence presented in this paper. Japanese TNCs are more concerned with local Chinese competition than they are with South Korean market penetration. METI and JETRO have also echoed similar opinions to that of Japanese TNCs operating in China.

As for KITA and FKI being concerned about competition with Japanese TNCs, MoTIE and MoFA have not registered the same concerns as these Korean business groups. There is a disjuncture between business interest groups in South Korea with their bureaucratic counterparts in the government that prevents this explanations from being strong enough to explain a lack of progress toward the China-Japan-South Korea FTA.

In regard to the PRC being concerned about domestic competition by Japanese and South Korea TNCs, the evidence suggests that the PRC has an open mind, making this a neutral explanation. As detailed in Chapter V, the China-South Korea FTA has shown that China is willing to open certain state-dominated sectors to foreign competition. This willingness may have even wider implications concerning Chinese plans to move the economy away from export-oriented growth toward endogenous domestic-demand growth by facilitating the creation of efficient, competitive, and profitable industrial sectors.

### **4. Strength of Evidence for Explanation 4: Concern over Historical and Political Animosities**

There is weak evidence for the fourth explanation of increased political-historical animosities affecting the Japanese so as to cause slow progress toward the trilateral FTA.

Evidence in concern of this explanation shows that the *Keidanren* has been driven in part by an attempt to overcome political-historical divides through economic interaction. The *Keidanren* have acted as middlemen for Japan between China and South Korea when relations have soured despite of poor public perceptions of China and South Korea at home. Additionally, Japanese TNCs have not registered negative impacts on business operations in either China or South Korea due to flare-ups in tensions.

There is strong evidence for increased political-historical animosities affecting the South Koreans, and thus slowing progress toward the trilateral FTA. There is evidence to show that political, historical, and territorial grievances affected previous bilateral FTA negotiations with the Japanese. Additionally, such animosities have been strong enough to spoil Japanese and South Korean business-to-business relationships over an extended period. Coupled with a pessimistic and hostile opinion of the South Korean public, historical-political animosities have created a serious roadblock for future cooperation with Japan, even in the trilateral context.

There is weak evidence for increased political-historical animosities affecting the Chinese so as to cause slow progress toward the trilateral FTA. Unlike South Korea, Sino-Japanese relations have remained stable despite historical-political flare-ups over the last 15 years. The ability of *Keidanren* to meet with Chinese business groups and political leaders have not been affected to the extent they have been in South Korea.

## **G. ORGANIZATION OF THESIS**

This thesis is divided into five additional chapters. The organization of these chapters is briefly outlined in this section.

Chapter II draws out the evolution of the China-Japan-South Korea FTA from 1999 onward within the context of both NEA economic regionalism and other competing mega-FTAs. The economic benefits and costs each country would incur if the trilateral FTA were successful are laid out in this chapter. Also, potential interest groups who particularly stands to win or lose in China, Japan, and South Korea from the trilateral FTA are identified. In addition, Chapter II provides a comparison of the benefits and costs of the trilateral FTA as compared to that of TPP and RCEP. Ultimately, these benefits and costs are conditional on the quality of the China-Japan-South Korea FTA.

Chapters III–V provide the empirical evidence that support the potential explanations that affect Chinese, Japanese, and South Korean decision-making toward the trilateral FTA. Each of these chapters frames the potential explanations in terms of the specific actors and interest groups at work in these countries. As the evidence is presented, strengths and weakness are assessed in order to determine which explanation is the strongest for each country.

Chapter VI reviews the strength of the empirical evidence from the previous chapters and provides regional implications of the potential success or failure of the trilateral FTA. In particular, implications for the U.S. role in the region are explored vis-à-vis NEA cooperation, and whether or not an exclusive trilateral FTA serves U.S. interests in the region.

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## **II. EVOLUTION AND OVERVIEW OF THE CHINA-JAPAN-SOUTH KOREA FTA**

### **A. INTRODUCTION**

This chapter will provide a description of the evolution and development of the China-Japan-South Korea FTA, its current status, and the potential distribution of economic gains. The first section of this chapter will detail the overall origins and development of Northeast Asian economic cooperation evolving into the currently negotiated trilateral FTA. The development of the trilateral FTA occurred over three distinct periods that saw slow progress (1999–2009), then rapid progress (2009–2012), and now slow progress (2012-present) to reach an agreement. The second part of this chapter will detail the distribution of economic gains in terms of GDP, economic sector impacts, and how the trilateral FTA compares to the other mega-FTA initiatives, Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP). Overall, the China-Japan-South Korea FTA grew out of a period when economic crises had pushed the Northeast Asian nations to cooperate on a more regular and deeper basis. In addition, the trilateral FTA came about when global trade liberalization had stalled in the WTO, and the countries of East Asia began forming regional multilateral alternatives. The China-Japan-South Korea FTA must now contend with the other mega-FTAs of RCEP and TPP in the region that offer their own unique gains for these Northeast Asian countries. Depending on the final configuration of the trilateral FTA, Japan seems to economically gain the least whereas China and South Korea gain the most.

### **B. ORIGINS AND DEVELOPMENT OF THE TRILATERAL FTA**

The development of the China-Japan-South Korea FTA can be separated across a timeline of three distinct periods. From 1999–2009, the trilateral FTA took shape in the form of proposals and studies within the context of greater East Asian cooperation. From 2009–2012, the countries of China, Japan, and South Korea created more momentum to

start negotiations while other mega-FTAs were being proposed. Despite the burst of energy to get the three countries to sit down for negotiations, from 2013 onward there has been slow progress to reach an agreement. The following section will outline the origins and development of the trilateral FTA while putting this timeline within context of wider Asia-Pacific economic cooperation.

## **1. Genesis of the FTA (1999–2009)**

The first joint announcement of a potential China-Japan-South Korea FTA was in 1999 on the margins of ASEAN Plus Three (APT) annual meetings, in the form of the Trilateral Economic and Trade Ministers' Meeting (TETM).<sup>84</sup> The APT grouping of countries include ASEAN member states plus China, Japan, and South Korea. From 2002 through 2009, China-Japan-South Korea worked on various initiatives that sought to create and strengthen financial and monetary regional institutions in the wake of the 1997–8 Asian Financial Crisis (AFC).<sup>85</sup> As a response to the AFC, the APT Executives' Meeting of East Asia Pacific Central Banks, which was created prior to the AFC, was strengthened.<sup>86</sup> Other institutions such as the APT Finance Minister Process was also strengthened and produced financial agreements such as the Chiang Mai Initiative (CMI), CMI Multilateralization (CMIM), Asian Bond Market Initiative (ABMI), and APT Macroeconomic Research Office (AMRO).<sup>87</sup>

Within the context of growing regional financial and monetary cooperation, separate trilateral meetings outside of the APT TETM concerning investment and trade were being held concurrently from 2002 through 2009. During this time period, various trilateral venues were created outside of the APT forum that involved all three economic and foreign ministries on the track-one level. Such meetings were annual and included

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<sup>84</sup> Srinivasa Madhur, "China-Japan-Korea FTA: A Dual Track Approach to a Trilateral Agreement," *Journal of Economic Integration* 28, no. 3 (September 15, 2013): 375–92, doi:10.11130/jei.2013.28.3.375.

<sup>85</sup> Ibid., 376.

<sup>86</sup> Ibid., Katada, "Regional Financial Cooperation," 130.

<sup>87</sup> See Dent (2011) for a complete breakdown of APT cooperation. John D. Ciorciari, "Chiang Mai Initiative Multilateralization: International Politics and Institution-Building in Asia," *Asian Survey* 51, no. 5 (September 2011): 930, doi:10.1525/as.2011.51.5.926; Dent, "Paths Ahead for East Asia and Asia-Pacific Regionalism," 968.



the following: Yellow Sea Rim Economic and Technological Conference, Government Consultations on the Improvement of Business Environment, and the Trilateral Economic Director-General Meetings. In addition to the previously listed venues, separate track-one foreign minister and leadership Trilateral Summit Meetings began in 2007 and 2008 respectively.

The growing regional financial and monetary cooperation in East Asia also occurred during the time in which further multilateral trade liberalization through the WTO Doha Round collapsed. The Doha Round had promised to build on the previous multilateral reforms brought by the conclusion of the Uruguay Round in 1994. The Doha Round of negotiations began in 2001 with an envisioned end date to negotiations by 2005. Yet, gridlock in negotiations between countries over agricultural tariffs and subsidies failed to produce an agreement. The inability to pursue global multilateral trade liberalization through the WTO spurred East Asian countries to pursue regional bilateral and multilateral FTAs “as a substitute for [global] multilateral regulation.”<sup>88</sup> As early as 2004, China and Japan were conducting feasibility studies for proposing regional multilateral FTAs. In 2004, China proposed an East Asia FTA (EAFTA) that included the APT.<sup>89</sup> In 2006, Japan proposed the Comprehensive Economic Partnership for East Asia (CEPEA) that included the ASEAN+6 grouping of countries, which are the ASEAN+3 states plus India, Australia, and New Zealand.<sup>90</sup> Along with the China-Japan-South Korea FTA, these mega-FTAs in the East Asia region “symbolize[d] a shift away from the long-standing WTO/APEC framework.”<sup>91</sup>

## **2. Maturation of the FTA (2009–2012)**

The 2002 through 2009 trilateral meetings outside of the APT forum of the TETM increased the level and amount of dialogue and cooperation, but official movement toward the China-Japan-South Korea FTA did not begin until 2009. The 2002–2009

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<sup>88</sup> Dieter, “Trade Integration in Asia,” 116.

<sup>89</sup> Masahiro Kawai and Ganeshan Wignaraja, “EAFTA or CEPEA: Which Way Forward?,” *ASEAN Economic Bulletin* 25, no. 2 (2008): 116, doi:10.1355/ae25-2a.

<sup>90</sup> Ibid.

<sup>91</sup> Ibid.

period is best considered by regional observers as “a long warming-up period for the trilateral economic cooperation.”<sup>92</sup> It was within the context of the 2009 second annual executive-level Trilateral Summit Meeting in which former Japanese Prime Minister Yukio Hatoyama pushed for an official joint study in concern of the trilateral FTA.<sup>93</sup> The joint study on the trilateral FTA did not occur until May 2010 and concluded in December 2011 with the release of the complete trilateral report in March 2012. In November 2012 during the annual ASEAN Economic Ministers Meeting (AEM), China-Japan-South Korea announced that they would begin to pursue FTA negotiations.<sup>94</sup>

From 2009 through 2012, China, Japan, and South Korea formalized trilateral economic cooperation through the creation of the Trilateral Cooperation Secretariat (TCS). During the 2009 second annual executive-level Trilateral Summit Meeting, the TCS was proposed and officially ratified by the three countries in 2011. As part of its mission, the TCS was mandated with promoting increased economic cooperation, regional development, people-people ties, environmental protection, and regional stability. In regard to economic cooperation, the TCS was tasked with pursuing the trilateral investment agreement as well as the trilateral FTA so that China, Japan, and South Korea may “continue to work toward further economic integration of the three countries in the long-term, including the establishment of a common market in the region.”<sup>95</sup> With the completion of the trilateral FTA study in 2011, the signing of the 2012 trilateral investment agreement, and the subsequent announcement of trilateral FTA negotiations beginning in the following year, the TCS had strong momentum from 2009 through 2012 to attempt to achieve its various goals. Overall, 2009 through 2012 marked the high water period of trilateral economic cooperation in Northeast Asia.

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<sup>92</sup> Madhur, “China-Japan-Korea FTA,” 376.

<sup>93</sup> Ibid.

<sup>94</sup> METI, “Announcement of the Launch of the FTA Negotiations among Japan, China and Korea,” accessed February 11, 2015, [http://www.meti.go.jp/english/press/2012/1120\\_01.html](http://www.meti.go.jp/english/press/2012/1120_01.html).

<sup>95</sup> “Trilateral Cooperation VISION 2020” (Seoul, South Korea: Trilateral Cooperation Secretariat, May 29, 2010), 3, [http://file.tcs-asia.org/file\\_manager/files/tcs/1.%20Basic%20Documents/1.%20English/\(2010.05.29\)Trilateral%20Cooperation%20VISION%202020.pdf](http://file.tcs-asia.org/file_manager/files/tcs/1.%20Basic%20Documents/1.%20English/(2010.05.29)Trilateral%20Cooperation%20VISION%202020.pdf).

Around this same time period, the mega-FTAs of TPP and RCEP began to gain traction in the region. TPP was originally known as the P4 FTA between Brunei, Chile, Singapore, and Malaysia in 2006. Later on in 2008, the U.S. joined the negotiations, and in the following years from 2009–2013, Australia, Canada, Mexico, Peru, Vietnam, and Japan joined TPP negotiations.<sup>96</sup> In addition to TPP, there was also the formation of RCEP during the 2012 East Asia Summit (EAS), which includes the ASEAN+6 countries.<sup>97</sup> The intent of RCEP was to harmonize the two other mega-FTA proposals by China and Japan, EAFTA and CEPEA.<sup>98</sup>

### **3. Recent Trilateral FTA Negotiations (2013 onwards)**

Trilateral FTA negotiations began in March 2013 and have continued with the seventh round in May 2015. The first two rounds of negotiations in March and August 2013 were designed to establish the framework for future negotiations. Yet, the third and fourth rounds in November 2013 showed that all three sides had still failed at establishing a framework for negotiation.<sup>99</sup> The disagreement centered on the scope of tariff reductions (trade liberalization) of whether or not the FTA should be a high or low quality FTA.<sup>100</sup> During the fifth round of negotiations in September 2014, the three sides exhibited signs of progress with statements to the effect that the trilateral FTA should be concluded before the end of 2015.<sup>101</sup> Yet, all three sides continued to fail at coming to

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<sup>96</sup> Murray Hiebert, Meredith Broadbent, and Lindsay Ross, “The Significance of the Trans-Pacific Partnership Negotiations,” *Center for Strategic and International Studies*, January 24, 2012, <http://csis.org/publication/significance-trans-pacific-partnership-negotiations>.

<sup>97</sup> Murray Hiebert and Liam Hanlon, “ASEAN and Partners Launch Regional Comprehensive Economic Partnership,” *Center for Strategic and International Studies*, December 7, 2012, <http://csis.org/publication/asean-and-partners-launch-regional-comprehensive-economic-partnership>.

<sup>98</sup> Ibid.

<sup>99</sup> “Japan, China, South Korea Fail To Set FTA Negotiation Framework,” *Jiji Press*, November 30, 2013, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPL2013113021296421#index=15&searchKey=18016653&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPL2013113021296421#index=15&searchKey=18016653&rpp=10).

<sup>100</sup> “Three-Way FTA Talks with Japan, China End with Little Progress,” *Yonhap News*, March 7, 2014, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPR2014030730979433#index=20&searchKey=18016585&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPR2014030730979433#index=20&searchKey=18016585&rpp=10).

<sup>101</sup> China Daily, “Pact ‘Should Be Done by 2015,’” accessed February 11, 2015, [http://www.chinadaily.com.cn/bizchina/2014-09/02/content\\_18527797.htm](http://www.chinadaily.com.cn/bizchina/2014-09/02/content_18527797.htm).

any concurrence as to the scope of the FTA.<sup>102</sup> At conclusion of the sixth round of negotiations in January 2015, the three sides remained deadlocked on issues of tariff reductions with the Japanese wanting more tariff lines eliminated than the Chinese and South Koreans.<sup>103</sup> The latest round of negotiations occurred in May 2015 with little change in discussion from the previous meeting. According to the South Korean Trade Minister present at the meetings, “Negotiations for the South Korea-China-Japan FTA are moving more slowly than we have expected.”<sup>104</sup>

#### **4. Slow Progress Despite 13 Years of Incremental Cooperation**

Overall, trilateral cooperation from 1999 to 2012 has allowed for the evolution of the trilateral FTA from an idea to a potentially negotiated agreement. Cooperation during this time period had been consistent and incremental, and had been marked by high water achievements such as the creation of the TCS and the trilateral investment agreement. There is a clear desire by each country to continue economic cooperation. Despite of the consistent and incremental build-up that preceded the FTA, basic issues of the scope and quality of the FTA cannot be agreed upon. The next section will show the differences in economic gains depending on the quality of FTA as well as how the trilateral FTA stacks up against the other mega-FTAs of TPP and RCEP in order to better understand some of the fundamentals that could cause the slowdown in progress toward the China-Japan-South Korea FTA.

### **C. COMPARISON OF RELATIVE GAINS AND FTA STANDARDS**

#### **1. Not all FTAs are Equal**

Opening a state’s economy to free trade pushes the potential GDP growth line above normal tariff-protected growth because free trade creates a virtuous cycle of more

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<sup>102</sup> Tokuhiko Saito and Go Kobayashi, “Japan, China, S. Korea Fail to Agree on Framework for FTA Talks,” *Asahi*, September 6, 2014.

<sup>103</sup> “Japan, China, S. Korea Fail to Agree on Trade Liberalization Target,” *Kyodo News*, January 17, 2015, <http://english.kyodonews.jp/news/2015/01/331935.html>.

<sup>104</sup> “South Korea, China, Japan Hold Talks for 3-Way FTA,” *Yonhap News*, May 12, 2015, <http://english.yonhapnews.co.kr/news/2015/05/12/56/0200000000AEN20150512001200320F.html>.

efficient, productive, competitive, and profitable sectors. Despite the creation of more efficient and profitable sectors of a state's economy, FTAs do not distribute economic gains equitably among partnering nations, nor are all FTAs the same quality of agreement. Besides distribution of gains between states, distribution of gains within each nation creates economic losers who can form interest groups that lobby against such FTAs. As noted by Mancur Olson, small and well organized interest groups—such as agricultural and industrial unions in developed nations—that stand to lose from an FTA will lobby for protection despite “reducing the efficiency and output of the society.”<sup>105</sup> This section will show how the China-Japan-South Korea FTA distributes economic gains as well as how the quality of the trilateral FTA affects the distribution of economic gains. Additionally, this section will compare how the trilateral FTA compares to TPP and RCEP, the region's other mega-FTA initiatives.

## **2. Who Gains More and Who Gains Less?**

According to the TCS, the China-Japan-South Korea FTA would increase GDP by an estimated .3%, .37%, and 3.55%, respectively.<sup>106</sup> These gains are based off of complete tariff elimination but not complete NTB elimination—not a WTO-plus agreement. The GDP increase estimate for a separate Korea–Japan FTA was valued at 1.09% and .02%, respectively, while estimates for a separate Korea–China FTA was at 2.45–3.1% and .4%–.6%, respectively.<sup>107</sup> A Japan-China bilateral FTA would give Japan a .36%–.66% GDP increase.<sup>108</sup> Overall, South Korea would be the net winner in relative GDP gains followed by Japan and China, if these projections held true.

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<sup>105</sup> Mancur Olson, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*, Kindle Edition (Yale University Press, 1984), Location 592.

<sup>106</sup> These numbers are based on a 2005 analysis by a Trilateral Research Project. Trilateral Cooperation Secretariat, “Free Trade Agreement.”

<sup>107</sup> Tomoyoshi Nakajima, “An Analysis of the Economic Effects of Japan-Korea FTA: Sectoral Aspects” (Niigata, Japan: Economic Research Institute for Northeast Asia, August 2002), 5, <https://www.erina.or.jp/en/Research/dp/pdf/0202e.pdf>; Hongshik Lee et al., “Economic Effects of a Korea-China FTA and Policy Implications” (Seoul, Korea: Korea Institute for International Economic Policy, December 30, 2005), 8, <http://www.kiep.go.kr/include/filedown.jsp?fname=POAN200503.pdf&fpath=Pub0201>.

<sup>108</sup> Kawasaki Kenichi, “The Relative Significance of EPAs in Asia-Pacific,” *The Research Institute for Economy, Trade, and Industry*, RIETI Discussion Paper Series, 14, no. E-009 (2014): 15.

In addition to overall economic gains, each countries' economic sectors would be affected differently. According to the TCS study, Chinese agriculture, textile, and electronics would benefit from the trilateral FTA, while its heavy industries would be out-competed by Japanese and South Korean peers (Figure 1). Japanese heavy industries—machinery, steel, automobiles, and chemicals—would benefit, but textile and agricultural sectors would experience decline (Figure 1). South Korean textiles, chemicals, and electronics sectors would benefit, but all other sectors would either decrease or see negligible effects from the FTA (Figure 1). Fewer South Korean sectors benefit from the trilateral FTA as compared to Japan and China. Even though fewer economic sectors stand to gain from the trilateral FTA in South Korea, those sectors are the most important to the South Korean economy, which is part of the reason why South Korea is projected as gaining the most in terms of GDP.

Figure 1. Sector Impacts from the Trilateral FTA

Cross-sector Industrial Impacts of the CJKFTA			
	China	Japan	ROK
<b>Agriculture</b>	+	-	-
<b>Fishery</b>	+	/	-
<b>Textile</b>	+	-	+
<b>Electronics</b>	+	/	+
<b>General Machinery</b>	-	+	-
<b>Steel</b>	/	+	/
<b>Automobiles</b>	-	+	/
<b>Chemical</b>	-	+	+

\* + means the output increases, - means the output decreases, and / means the impact is quite small

From Trilateral Cooperation Secretariat, "Free Trade Agreement," *2013 Trilateral Statistics*, accessed December 8, 2014, [http://www.tcs-asia.org/dnb/user/userpage.php?lpage=3\\_6\\_2\\_contents](http://www.tcs-asia.org/dnb/user/userpage.php?lpage=3_6_2_contents).

### 3. Low Quality vs. High Quality FTAs

The ability of the trilateral FTA to distribute economic gains as well as affect particular sectors of the Chinese, Japanese, and South Korean economies depends on the quality of the FTA. FTAs are not uniform as they can possess differing trade-liberalizing qualities. High-quality FTAs produce agreements that liberalize trade beyond the current WTO multilateral agreements. Such high quality FTAs, often referred to as “WTO-plus” agreements, open up sectors to competition that have not been affected by the Uruguay Round.<sup>109</sup> In addition to tariff reductions, WTO-plus FTAs eliminate non-tariff barriers (NTBs) that limit the quantity of imports through quotas or voluntary export restraints (VERS), increase cost of getting product to market through excessive rules of origin (ROO), and domestic subsidies for particular industries. Low-quality FTAs are those agreements that merely lock in unilateral tariff reduction, maintain NTBs, preserve prior existing agreements, and include carve-outs and other exceptions.<sup>110</sup> A higher quality trilateral FTA would magnify the relative gains and losses facing sectors. Previously signed bilateral FTAs with ASEAN (ASEAN+1 FTAs ) separately negotiated by China, Japan, and South Korea are low-quality FTAs that have yielded low levels of tariff liberalization (between 94% to 90% tariff elimination) and have not included non-tariff measures.<sup>111</sup> Essentially, FTAs among East Asian states have tended to lock-in preexisting trade flows and value-added trade networks without opening previously protected sectors.

If East Asian FTAs merely formalize the trade status-quo through low levels of tariff elimination, then existing trade patterns between China, Japan, and South Korea can indicate which state potentially stands to gain less, in terms of both economic and efficiency gains, from the trilateral FTA. According to Thomas Hale, there already exists a de-facto trade network among China, Japan, and South Korea that has been created by

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<sup>109</sup> Sally, “Free Trade Agreements and the Prospects for Regional Integration in East Asia,” 308.

<sup>110</sup> Menon, “Preferential and Non-Preferential Approaches to Trade Liberalization in East Asia,” 4.

<sup>111</sup> Kenichi, “The Relative Significance of EPAs in Asia-Pacific,” 15.

unilateral tariff reductions.<sup>112</sup> China, Japan, and South Korea have created a de-facto trade network that covers their value-added trade goods.<sup>113</sup> As of 2012, China and South Korea have enjoyed preferential access into the Japanese non-agricultural market with 68.8% and 54%, respectively, of all non-agricultural tariff lines reduced to duty-free.<sup>114</sup> Total tariff lines from China and South Korea that are duty-free are 52.4% and 36.5%, respectively.<sup>115</sup> Additionally, Chinese and South Korean non-agricultural duty-free imports to Japan account for 73% and 64.6% of the value of all traded goods, respectively.<sup>116</sup> Yet, Japan only receives 9.3% and 14.9% non-agricultural duty-free tariff lines from China and South Korea, respectively.<sup>117</sup> Japan primarily exports non-agricultural products to China and South Korea, on the order of over 99% of the value of all traded goods, and of the total value of non-agricultural goods imported by Japan from China and South Korea, 67.5% and 73.2% have tariffs levied, respectively.<sup>118</sup>

The end result of the de-facto NEA trade network is a lopsided arrangement that benefits China and South Korea over Japan. Such an arrangement would be enhanced and elevated to de-jure status by a trilateral FTA along the lines of an ASEAN+1 FTA—a low quality FTA that locks in preexisting tariffs and NTBs. Considering Japan’s dwindling trade surplus with South Korea and ballooning trade deficit with China, Japan’s negative balance of payment in terms of traded goods would be locked in by a low quality trilateral FTA (Figure 2). Thus, in terms of reinforcing trade flows and creating efficient trade networks, Japan has the least to gain by a low quality trilateral FTA.

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<sup>112</sup> Thomas Hale, “The de Facto Preferential Trade Agreement in East Asia,” *Review of International Political Economy* 18, no. 3 (August 2011): 299–327, doi:10.1080/09692290.2010.484303.

<sup>113</sup> Ibid.

<sup>114</sup> World Trade Organization, “Tariff Profiles,” accessed March 15, 2015, <http://stat.wto.org/TariffProfile/WSDBTariffPFView.aspx?Language=E&Country=CN,JP,KR>.

<sup>115</sup> Ibid.

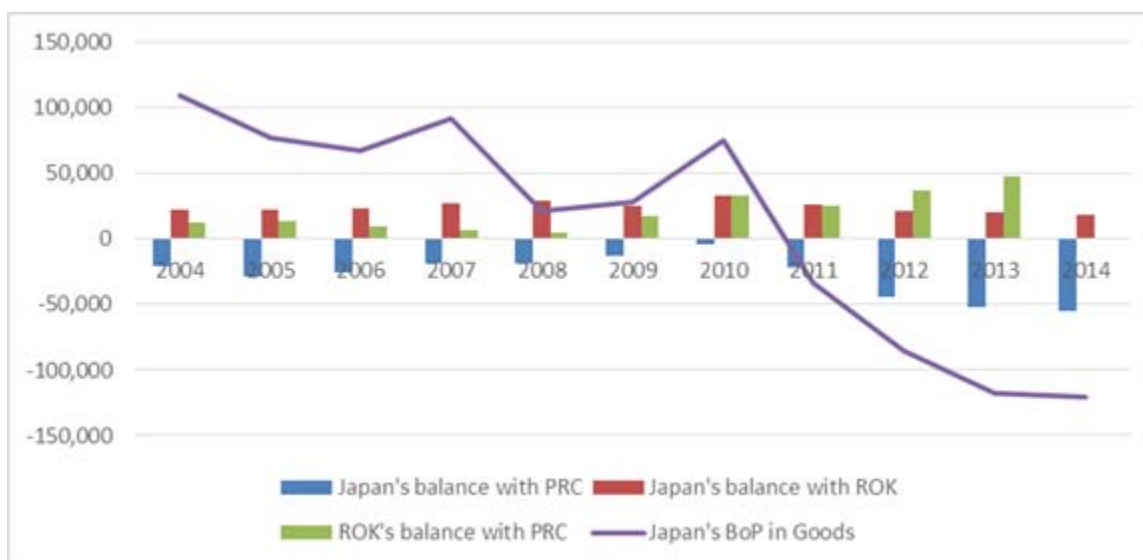
<sup>116</sup> Ibid.

<sup>117</sup> Ibid.

<sup>118</sup> World Trade Organization, “Tariff Profiles.”



Figure 2. Balance of Payments (BoP) in Traded Goods in Millions of USD



Balance of Payments in traded goods from JETRO and Bank of Korea statistics.

The quality of the FTA will also affect whether countries will receive the full benefits of GDP gains as predicted, such as those predicted by the TCS joint study. The GDP gains cited by the TCS study are based on complete tariff elimination, but does not factor in elimination of NTBs.<sup>119</sup> For instance, if Japan and China were to unilaterally forgo all their NTBs, their economies would receive a GDP boost of 1% and 3%, respectively.<sup>120</sup> Thus, if the trilateral FTA were a high quality, WTO-plus agreement, then China, Japan, and South Korea could stand to gain more than the TCS study predictions. The implication in this scenario is that losing sectors in each economy would become more efficient, and the countries would receive greater economic welfare gains.

<sup>119</sup> Development Research Center of the State Council of China, National Institute for Research Advancement of Japan, and Korea Institute for International Economic Policy, "Joint Study Report for an FTA among China, Japan, and Korea," 7th Trilateral Joint Research on Possibilities and Prospects for the China-Japan-Korea FTA (Tokyo, Japan: Trilateral Cooperation Secretariat, September 2, 2009), 8, [http://www.tcs-asia.org/dnb/board/view.php?board\\_name=3\\_2\\_1\\_trade&view\\_id=23&search\\_cate=Joint+Research+on+a+Possible+Free+Trade+Agreement+among+the+Three+Countries](http://www.tcs-asia.org/dnb/board/view.php?board_name=3_2_1_trade&view_id=23&search_cate=Joint+Research+on+a+Possible+Free+Trade+Agreement+among+the+Three+Countries).

<sup>120</sup> Development Research Center of China, Japan External Trade Organization, and Korea Institute for International Economic Policy, "7th Trilateral Joint Research on Possibilities and Prospects for the China-Japan-Korea FTA" (Trilateral Cooperation Secretariat, October 2009), 23, [http://file.tcs-asia.org/file\\_manager/files/tcs/4.%20Economy/1.%20English/01.%20Trade%20and%20Investment/\(2009.10\)%20Joint%20Research%20Report%20and%20Policy%20Recommendations%20on%20CJK%20FTA%20-%20Phase%202.pdf](http://file.tcs-asia.org/file_manager/files/tcs/4.%20Economy/1.%20English/01.%20Trade%20and%20Investment/(2009.10)%20Joint%20Research%20Report%20and%20Policy%20Recommendations%20on%20CJK%20FTA%20-%20Phase%202.pdf).

If the trilateral FTA is of a low quality, however, then the gains in terms of efficiency and welfare gains will be reduced depending on which tariff lines are eliminated.

Additionally, the promises of economic gains from other mega-FTAs in the Asia-Pacific detract from placing the China-Japan-South Korea FTA as a priority agreement. For Japan, TPP promises the most gains in terms of GDP growth due to American insistence on a high-quality Asia-Pacific FTA as compared to lower gains due to the likelihood that either the trilateral or RCEP FTA would have a low level of tariff liberalization similar to ASEAN+1 FTAs (Table 1). The recent conclusion of the China-South Korea FTA, which has a 91% tariff elimination level and includes large sector carve-outs on both sides, confirms that a trilateral FTA would be a low quality FTA similar to that of an ASEAN+1 FTA.<sup>121</sup> If the trilateral FTA is similar in form to the China-South Korea FTA, then complete tariff elimination will not occur and GDP gains for all three will be much lower than what the TCS predicted. Given that estimates on the lower end of Table 1 only assume complete tariff and not non-tariff measure elimination, a trilateral or RCEP agreement similar to the recent China-South Korea FTA would fall below the lower range of potential GDP growth gains. Thus, if Japan doubles down on trilateral FTA negotiations over TPP's promises of a high-quality agreement, then Japan forgoes more gains in terms of potential GDP growth. As for China and South Korea, which are not included in TPP, the trilateral FTA could serve as a means for compensatory gains to balance potential losses in GDP due to a successful TPP.

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<sup>121</sup> Calculated from tariff schedules provided by Ministry of Trade, Industry, and Energy, "China-Korea FTA," *FTA Korea*, accessed March 24, 2015, <http://www.fta.go.kr/cn/doc/1/>.

Table 1. Potential GDP Gains (%)

	Trilateral FTA	TPP	RCEP	FTAAP
China	.3%	-.3% to -.4%	1.5% to 3.4%	3.9% to 6%
Japan	.37%	.8% to 2.2%	1.9% to 2.8%	2.1% to 4.3%
South Korea	3.55%	-.2% to -.6%	4.1% to 6.4%	6.1% to 7.1%

Potential gains in terms of percent of GDP are listed from the currently negotiated trilateral FTA, TPP, and RCEP as well as a potential Free Trade Area of the Asia-Pacific (FTAAP). The lower range of values are potential gains from complete tariff elimination. The higher range of values are potential gains from complete tariff and non-tariff measures elimination. The values for the trilateral FTA are potential gains from only complete tariff elimination. These figures are a composite from TCS, PIIE, and RIETI figures.<sup>122</sup>

#### D. CONCLUSION

Overall, South Korea gains the most in terms of overall GDP from a trilateral FTA, and Japan gains the least. Yet, South Korea has more sectors negatively affected by the trilateral as compared to either China or Japan. When assessing the gains of low or high quality FTA, Japan stands to gain the least as well as perpetuate a negative balance of trade with China if Japan accepts a low quality trilateral FTA. On the flipside, a low-quality trilateral FTA will lock-in existing trade patterns in Northeast Asia to the benefit of China. Additionally, Japan stands to gain the most with a high-quality TPP that has a stated aim of reducing NTBs vice a trilateral FTA that currently does not guarantee complete tariff elimination and does not reduce NTBs. Yet, the fallout of a successful TPP has a negative effect in terms of reduced GDP for China and South Korea, thus making a successful trilateral FTA more in their interest.

Relative gains in terms of GDP is not the only reason for a lack of progress toward a trilateral FTA. All three countries' ministries of foreign affairs still tout the economic gains as predicted by the TCS study. None of these governments have come out explicitly against or critical of the trilateral FTA. As established in Chapter I, there

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<sup>122</sup> Trilateral Cooperation Secretariat, "Free Trade Agreement"; Peter A. Petri, Michael G. Plummer, and Fan Zhai, *Economic Implications of the Trans-Pacific and Asian Tracks Economic Implications of the Trans-Pacific and Asian Tracks*, Policy Analyses in International Economics 98 (Washington, D.C: Peterson Institute for International Economics, 2012), [http://www.piie.com/publications/chapters\\_preview/6642/04iie6642.pdf](http://www.piie.com/publications/chapters_preview/6642/04iie6642.pdf); Kenichi, "The Relative Significance of EPAs in Asia-Pacific."

are four potential explanations for why China, Japan, and South Korea have slow-rolled progress toward a trilateral FTA despite never overtly signaling displeasure with the FTA. Perceptions of the deal not being an economic priority, the power of influential domestic business interests negatively affected by the FTA, regional competition over China's growing domestic market, and regional political-historical animosities play potential roles for slowing progress on all sides of the negotiating table. The following three chapters will analyze the causal strength of each of these explanations in each country to assess how the four factors affect slow progress toward the trilateral FTA.

### **III. JAPAN: TRILATERAL FTA NOT AN ECONOMIC PRIORITY FOR JAPAN**

#### **A. INTRODUCTION**

This chapter will test four potential explanations on how Japan has approached the China-Japan-South Korea FTA that has caused a lack of progress in concluding negotiations. These explanations focus on Japanese perceptions of economic priority, domestic interests, foreign business competition, and political-historical grievances. The chapter will argue that the strongest reason for a lack of progress is that Japan does not view the trilateral FTA as an economic priority. After outlining the four potential explanations, the following sections will examine the evidence in order to test the causal strength of each explanation.

#### **B. EVIDENCE AND ANALYSIS**

As detailed in Chapter I, there are four potential explanations that would cause each country to accept a lack of progress toward a China-Japan-South Korea FTA. This section will examine each of the four explanations that potentially motivate Japan in not pursuing the trilateral FTA in order to show that Japan does not view the trilateral FTA as an economic priority.

##### **1. Explanation 1: Japanese Economic Priority**

The first potential explanation to be tested is if Japan does not view the trilateral FTA as an economic priority, then the China-Japan-South Korea FTA is less likely. For evidence, this explanation will assess the positions taken by the Japanese business advocacy group *Nippon Keidanren*. On the government side, positions taken by the Ministry of Economy, Trade, and Industry (METI) as well as the related government-run Japan External Trade Organization (JETRO) will be assessed. This section will show that Japanese business interests do not view the trilateral FTA as an economic priority relative to the other mega-FTAs in the Asia-Pacific. While the *Keidanren* have voiced support for

the trilateral FTA since 1999, they have more recently prioritized TPP, and their opinion on such economic priority has been echoed by METI and JETRO.

*a. Evidence: Keidanren's view of Asia-Pacific FTAs*

(1) Prioritization of the WTO and the Doha Round

From 1999 to 2005, the *Keidanren* consistently stated their support for the China-Japan-South Korea FTA, but as a lower priority as compared to furthering global trade liberalization through the WTO. When the trilateral FTA was first proposed in 1999, the *Keidanren* supported a trade policy that focused Japan's "efforts toward a new round of World Trade Organization (WTO) negotiations [the Doha Round]."<sup>123</sup> The *Keidanren* insisted that the WTO should be at the center of Japan's trade policy while also pursuing regional FTAs. In a 1999 policy statement, the *Keidanren* emphatically stated that "one of the top priorities of Japan's trade policy is strengthening the WTO system."<sup>124</sup> Bilateral and regional FTAs were seen as a means of affecting future WTO negotiations. FTAs such as the trilateral FTA serve Japanese interest by strengthening "negotiating power in . . . WTO negotiations."<sup>125</sup> Support by *Keidanren* for regional FTAs from 1999 to 2005 should be seen as part of a policy recommendation that maintained an emphasis on WTO expansion and greater trade liberalization. For the *Keidanren*, rules for allowing greater trade liberalization were to be created through the WTO and applied to regional FTAs. For instance, in 2001, the *Keidanren* stated that Japan must proceed with FTAs with not only China and South Korea, but also with the NAFTA countries and ASEAN.<sup>126</sup> *Keidanren* chairman Kenji Miyahara's 2004 statement supported the creation of a trilateral FTA but also "considering a free trade zone that compromises the members of the Association of Southeast Asian Nations and Japan, China and South Korea, as well

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<sup>123</sup> "Urgent Call for Active Promotion of Free Trade Agreements" (Tokyo, Japan: Nippon Keidanren, July 18, 2000), <http://www.keidanren.or.jp/english/policy/2000/033/proposal.html>.

<sup>124</sup> "Challenges for the Upcoming WTO Negotiations and Agendas for Future Japanese Trade Policy" (Tokyo, Japan: Nippon Keidanren, May 18, 1999), <http://www.keidanren.or.jp/english/policy/pol102/proposal.html#part1>.

<sup>125</sup> Ibid.

<sup>126</sup> "Keidanren Calls For Regional Trade Accords," *Jiji Press*, June 14, 2001, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPP20010614000109#index=61&searchKey=18155651&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPP20010614000109#index=61&searchKey=18155651&rpp=10).

as an FTA with the United States.”<sup>127</sup> All of the WTO-plus rules created through the then proposed Doha Round would be applied to these FTAs.

From 2006 onward, the priority of the WTO in the eyes of the *Keidanren* would diminish after a string of setbacks in Doha Round negotiations. Following the failure of the Doha Round to come to any agreement at the end of 2005, the *Keidanren* shifted its focus toward regional FTAs as means for creating WTO-plus rules in what the *Keidanren* saw as diminishing Japanese influence in the region. In a 2006 policy proposal, *Keidanren* registered concern that the failure of the Doha Round was causing “an erosion of confidence in the multilateral free trade system centered on the WTO.”<sup>128</sup> In addition, the *Keidanren* noted that other regional countries—China and South Korea—were aggressively pursuing FTAs and “turning them into arenas of international competition.”<sup>129</sup> At the same time as these comments, proposals for overlapping regional FTAs such as the Chinese promoted ASEAN+3 FTA (EAFTA) and the Japanese ASEAN+6 FTA (CEPEA) were being studied.<sup>130</sup> The proposal suggested that “the conclusion of mutually beneficial EPAs [FTAs] particularly with East Asian neighbors . . . constitutes an indispensable condition for Japan as well as other Asian countries to develop together as the growth center of the world.”<sup>131</sup> After the failure of the Doha Round to come to a conclusion in 2008, the *Keidanren* continued its trope of encouraging the Japanese government to prioritize FTAs, specifically mega-FTAs that would bind the entire Asia-Pacific region in-lieu of a WTO agreement in order to create new WTO-plus rules in the region.

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<sup>127</sup> “Japan: Keidanren Members Seek Stronger Economic Ties With Asian Nations,” *Nihon Keizai Shimbun*, July 24, 2004, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPP20040724000028#index=112&searchKey=18155651&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPP20040724000028#index=112&searchKey=18155651&rpp=10).

<sup>128</sup> “Toward Broader and Deeper Economic Partnership” (Tokyo, Japan: Nippon Keidanren, October 17, 2006), <http://www.keidanren.or.jp/english/policy/2006/072/proposal.html>.

<sup>129</sup> Ibid.

<sup>130</sup> Kawai and Wignaraja, “EAFTA or CEPEA: Which Way Forward?”

<sup>131</sup> “Toward Broader and Deeper Economic Partnership.”

## (2) Shift toward prioritizing regional multilateral FTAs

The greatest emphasis on recommending the China-Japan-South Korea FTA as a priority for Japanese trade policy would occur during 2010 and 2011. In the context of larger regional agreements such as EAFTA and CEPEA agreements, *Keidanren* saw the trilateral FTA as a necessary antecedent. In the run-up to the 2010 APEC meeting, the *Keidanren* put forward its vision of Japanese trade policy.<sup>132</sup> In its policy proposal, *Keidanren* envisioned three parallel paths toward an overarching Asia-Pacific trade agreement. These paths included ASEAN+3 EAFTA, ASEAN+6 CEPEA, and TPP agreements as all necessary preconditions to the ultimate goal of an FTAAP, and each would be given equal priority. The China-Japan-South Korea FTA fit into this scheme under the ASEAN+3 track.<sup>133</sup> A 2011 *Keidanren* policy proposal suggested that Japan should focus primarily on FTA promotion while still integrating WTO-plus rules from the moribund Doha Round.<sup>134</sup> According to the proposal, Japan should prioritize the “conclusion of EPAs [FTAs] . . . through the frameworks of the TPP, ASEAN+6 [CEPEA], and Japan-EU EIA, respectively.”<sup>135</sup> Concurrent to the 2011 policy proposal, *Keidanren* issued a statement that the China-Japan-South Korea FTA would “fill a vital gap in East Asian economic integration and play a crucial role in achieving ASEAN+3 and ASEAN+6 as well as in achieving APEC-level regional economic integration in the form of a Free Trade Area of the Asia-Pacific (FTAAP).”<sup>136</sup> Thus, the *Keidanren* framed the trilateral FTA as a bridge to allow for the creation of EAFTA and CEPEA agreements in order to achieve the larger goal of FTAAP.

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<sup>132</sup> “Toward Sustainable Growth in the Asia-Pacific Region: Japan’s Responsibility as Host Country for APEC 2010” (Tokyo, Japan: Nippon Keidanren, June 15, 2010), <http://www.keidanren.or.jp/en/policy/2010/054summary.pdf>.

<sup>133</sup> Ibid.

<sup>134</sup> “Proposals for Japan’s Trade Strategy,” Policy Proposals (Tokyo, Japan: Nippon Keidanren, April 19, 2011), <http://www.keidanren.or.jp/en/policy/2011/030proposal.html#part3>.

<sup>135</sup> Ibid.

<sup>136</sup> “The Third Japan-China-Korea Business Summit Joint Statement” (Tokyo, Japan: Nippon Keidanren, May 22, 2011), <http://www.keidanren.or.jp/en/policy/2011/052.html>.



### (3) Prioritization of TPP

By 2012, however, the priority of the China-Japan-South Korea FTA as a necessary antecedent for proceeding along a multi-track approach toward FTAAP changed. A 2012 policy proposal specifically singled out TPP as leverage that could be used in Japan's favor for promoting WTO-plus rules in negotiations for the China-Japan-South Korea FTA and CEPEA.<sup>137</sup> In addition, the *Keidanren* in 2013 altered its view of three parallel paths all leading to FTAAP. A 2013 policy proposal specifically called for pursuing "TPP as a route to creating a Free Trade Area of the Asia-Pacific (FTAAP), a Japan-China-Korea FTA, a Regional Comprehensive Economic Partnership (RCEP), and a Japan-EU EPA."<sup>138</sup> There had been earlier statements by *Keidanren* in 2012 that described TPP "as a springboard for a Comprehensive Economic Partnership in East Asia (CEPEA) framework, in the ultimate aim of creating a Free Trade Area of the Asia-Pacific (FTAAP)."<sup>139</sup> By 2013, a shift had occurred in which ASEAN+3 and ASEAN+6 tracks, which as of 2013 were now embodied by RCEP rather than EAFTA and CEPEA, had been separated from the goal of creating an FTAAP. For the *Keidanren*, the ASEAN track through RCEP was now concerned with harmonizing trade rules for "supply chain and value chain continuity."<sup>140</sup> TPP, according to Chairman Hiromasa Yonekura of *Nippon Keidanren*, "as the most promising route to creating a . . . FTAAP," and called for an agreement to be reached as soon as possible.<sup>141</sup>

Since 2012, *Keidanren* has placed priority on the TPP rather than on the China-Japan-South Korea FTA. In *Keidanren's* 2013 policy proposal, the trilateral FTA had been unpacked from the ASEAN track negotiations.<sup>142</sup> Unlike its 2010 policy proposal

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<sup>137</sup> "Urgent Proposal: For Promotion of Economic Partnerships by Leveraging TPP" (Tokyo, Japan: Nippon Keidanren, June 11, 2012), <http://www.keidanren.or.jp/en/policy/2012/042.html>.

<sup>138</sup> "Proposals for Redefining of Trade Strategy," Policy Proposals (Tokyo, Japan: Nippon Keidanren, April 16, 2013), [http://www.keidanren.or.jp/en/policy/2013/034\\_proposal.html#part2](http://www.keidanren.or.jp/en/policy/2013/034_proposal.html#part2).

<sup>139</sup> "Keidanren Mission to ASEAN Observations of Keidanren Chairman Hiromasa Yonekura" (Tokyo, Japan: Nippon Keidanren, March 9, 2012), <http://www.keidanren.or.jp/en/policy/2012/015.html>.

<sup>140</sup> "Stronger Ties with ASEAN Member States" (Tokyo, Japan: Nippon Keidanren, December 11, 2013), <http://www.keidanren.or.jp/en/policy/2013/109.html>.

<sup>141</sup> Nippon Keidanren, "Call for the Early Conclusion of the TPP Negotiations" (Keidanren, February 20, 2014), <http://www.keidanren.or.jp/en/policy/2014/009.html>.

<sup>142</sup> "Proposals for Redefining of Trade Strategy."

that saw the trilateral FTA as a stepping stone toward ASEAN+3 and ASEAN+6 trade agreements, the *Keidanren* no longer insisted that the trilateral FTA was a precondition for either RCEP or FTAAP from 2012 onward. Positions taken by *Keidanren* in 2010 and 2011 were the closest pieces of evidence that suggested recommending Japan prioritize the China-Japan-South Korea FTA relative to other mega-FTAs. Based on *Keidanren's* 2012 policy proposal forward, the China-Japan-South Korea FTA as well as RCEP was now contingent upon the progress of TPP negotiations, and relatively not as prioritized as TPP.

As early as 2010, *Keidanren* Chairman Hiromasa Yonekura had been issuing statements that preluded *Keidanren's* formal policy proposals of prioritizing TPP over other regional trade agreements such as the trilateral FTA. In a November 2010 statement issued by Yonekura, he implored that Japan must “declare its participation in the TPP talks at the APEC summit,” or else be “left behind the world’s growth and prosperity.”<sup>143</sup> In the same statement, Yonekura clearly stated that Japan’s involvement in TPP would guide any future FTAs with China to include a trilateral FTA.<sup>144</sup> Meeting with the Japanese Ministry of Foreign Affairs in 2010, Chairman Yonekura advised that involvement with the TPP “would enhance Japan’s ‘strategic position’ and contribute to the promotion of FTA talks between Japan, China, and South Korea.”<sup>145</sup>

Additionally, the *Keidanren* in its publications and statements has not affixed specific values in terms of economic welfare gains to the trilateral FTA or to TPP and RCEP. The *Keidanren* emphasizes certain macro-level promises that could result from these trade negotiations rather than quote specific valuations in welfare gain to the Japanese economy. The *Keidanren* have chosen to focus on TPP in terms of reforming

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<sup>143</sup> “Japanese Business Groups Urge PM Kan To Join Pacific Free-Trade Talks at APEC,” *AFP*, November 1, 2010, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPP20101101969068#index=491&searchKey=18155774&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPP20101101969068#index=491&searchKey=18155774&rpp=10).

<sup>144</sup> *Ibid.*

<sup>145</sup> “Business Lobby Seeks Conclusion of Trans-Pacific FTA by 2015,” *Kyodo World Service*, November 8, 2010, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPP20101108969016#index=494&searchKey=18155774&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPP20101108969016#index=494&searchKey=18155774&rpp=10).

the Japanese domestic economy while furthering WTO-plus rules.<sup>146</sup> RCEP enhances Japan's access to regional value chains despite the presence or lack of presence of WTO-plus rules.<sup>147</sup> What the trilateral FTA offers is similar to that of RCEP in that it enhances regional value chains established by Japanese TNCs.<sup>148</sup> Since 2012, however, the *Keidanren* has not clarified its position as to the priority of the trilateral FTA vis-à-vis RCEP. Recent statements by Chairman Yonekura, such as a May 2014 Japan–South Korea Business Conference in which he stated that the trilateral FTA would serve as the “foundation for wider economic cooperation in the Asia-Pacific region,” seem out of place when put in context with *Keidanren* policy proposals over the last three years.<sup>149</sup> No *Keidanren* policy proposal or statement has made the trilateral agreement contingent to Japanese goals of furthering WTO-plus rules, effecting domestic economic changes, or enhancing regional trade flows. What comes first for the *Keidanren* in order to enhance regional value chains, RCEP or the China-Japan-South Korea FTA, remains an open question.

#### (4) *Keidanren's* Position in Review

Since the trilateral FTA's proposal in 1999, the *Keidanren* have, for the most part, subordinated the China-Japan-South Korea FTA in priority relative to other trade agreements. In the first half of the 2000s, the *Keidanren* were focused on accelerating the Doha Round of the WTO in order to create new WTO-plus rules. After 2008 and specifically during the years of 2010 and 2011, the *Keidanren* was the most vocal about pursuing the trilateral FTA as a priority in order to achieve the larger goals of CEPEA, EAFTA, and FTAAP. From 2012 and onward, the *Keidanren* have subordinated in priority the China-Japan-South Korea FTA in order to focus on TPP negotiations, which it sees as giving Japan significant leverage in negotiating the trilateral FTA, RCEP, and the terms of a future FTAAP. The shift in priority has tracked with what the *Keidanren*

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<sup>146</sup> Nippon Keidanren, “Call for the Early Conclusion of the TPP Negotiations.”

<sup>147</sup> “Stronger Ties with ASEAN Member States.”

<sup>148</sup> “Proposals for Redefining of Trade Strategy.”

<sup>149</sup> “Kyodo: Business Lobby Seeks Stronger Economic Ties Between Japan, S. Korea,” *Kyodo World Service*, May 14, 2014, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPR2014051436773160#index=763&searchKey=18155774&rpp=10.!](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPR2014051436773160#index=763&searchKey=18155774&rpp=10.)

has believed to be the best means to achieve WTO-plus rules in the Asia-Pacific region. The *Keidanren*'s period of support for the China-Japan-South Korea FTA should be seen within the context of an intermediate period following the stagnation of the Doha Round and the emergence in confidence of the TPP to create WTO-plus rules. As the *Keidanren* do not currently perceive the trilateral FTA as endogenously producing WTO-plus rules, the priority for this FTA is lower relative to that of TPP.

***b. METI and JETRO Policy Position***

**(1) Echoing Concerns of *Keidanren***

The opinions of the Japanese Ministry of Economy, Trade and Industry (METI) and the Japan External Trade Organization (JETRO) are key to understanding because they provide the economic research and policy creation for the Japanese government. These actors in the Japanese bureaucracy are connected to their business counterparts in the private sector in an iron-triangle of politicians, bureaucrats and businessmen.<sup>150</sup> METI and JETRO have followed suit with *Keidanren* in the last two years. The 2013 JETRO White Paper emphasized the singular importance of the TPP in that it “signaled the arrival of the mega FTA.”<sup>151</sup> By 2014, JETRO and METI white papers listed the China-Japan-South Korea FTA as part of the larger RCEP agreement as well as highlighting the importance of TPP. The 2014 METI White Paper had an anemic description of the China-Japan-ROK FTA. METI gives a half page to the trilateral FTA as compared to the six pages for TPP and three pages for RCEP negotiations, and simply describes the trilateral negotiations as “lively discussions” that are “progressing steadily.”<sup>152</sup> The 2014 JETRO White Paper states that the “mutual complement of the

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<sup>150</sup> Johnson, “Political Institutions and Economic Performance.”

<sup>151</sup> “2013 JETRO Global Trade and Investment Report: Revitalizing Japan through Global Business,” JETRO White Paper (Tokyo, Japan: JETRO, August 8, 2013), 30, [http://www.jetro.go.jp/en/reports/white\\_paper/trade\\_invest\\_2013\\_overview.pdf](http://www.jetro.go.jp/en/reports/white_paper/trade_invest_2013_overview.pdf).

<sup>152</sup> “2014 METI White Paper: Strengthening Links to the Global Economy via Economic Partnerships” (Tokyo, Japan: METI of Japan), 274, accessed February 25, 2015, <http://www.meti.go.jp/english/report/downloadfiles/2014WhitePaper/3-1-1.pdf>.

TPP and RCEP contributes toward the realization of . . . FTAAP.”<sup>153</sup> Similar to *Keidanren* insistence that Japan use TPP negotiations to affect the tone of other regional negotiations, the JETRO paper states that Japan’s involvement in the TPP can be used to “raise the levels of liberalization of RCEP.”<sup>154</sup>

Similar to the *Keidanren*, METI and JETRO characterize the benefits of the mega-FTAs not in terms of absolute economic welfare gains, but rather, in terms of potential macroeconomic benefits such as WTO-plus rule making and strengthening preexisting value-chains. According to the 2014 METI White Paper, “TPP is an ambitious attempt . . . creating new rules covering not only high-level tariff elimination,” but also WTO-plus rules.<sup>155</sup> In regard to RCEP, the METI white paper says RCEP would bring about “the standardization of rules and streamlining of procedures . . . and provide support for the overseas expansion of Japanese industry” without necessarily including WTO-plus rules.<sup>156</sup> In an identical fashion, the 2014 JETRO White Paper frames TPP as “oriented toward the establishment of high-level rules,” whereas RCEP creates “business-friendly framework in as aspects such as supply-chains.”<sup>157</sup>

The METI and JETRO white papers, however, do not explicitly state a particular benefit of the China-Japan-South Korea FTA in similar terms as TPP or RCEP. METI refers to the previous joint studies already discussed in Chapter II with an opaque final statement that the trilateral FTA should be concluded as a “comprehensive, high-level agreement.”<sup>158</sup> The 2014 JETRO White Paper frames the China-Japan-South Korea FTA in a completely different light as being a necessary part of the Japanese government’s

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<sup>153</sup> “2014 JETRO Global Trade and Investment Report: On Making Japan a Base for International Business Circulation,” JETRO White Paper (JETRO, August 7, 2014), 17, [http://www.jetro.go.jp/en/reports/white\\_paper/trade\\_invest\\_2014\\_overview.pdf](http://www.jetro.go.jp/en/reports/white_paper/trade_invest_2014_overview.pdf).

<sup>154</sup> Ibid.

<sup>155</sup> “2014 METI White Paper: Strengthening Links to the Global Economy via Economic Partnerships,” 467.

<sup>156</sup> Ibid., 472.

<sup>157</sup> “2014 JETRO Global Trade and Investment Report: On Making Japan a Base for International Business Circulation,” 17.

<sup>158</sup> “2014 METI White Paper: Strengthening Links to the Global Economy via Economic Partnerships,” 474.

goal to conclude FTAs that will cover more than 84% of Japan's trade as opposed to the current FTA trade coverage of 18.2%.<sup>159</sup>

*c. Summary of Evidence and Analysis*

Overall, *Keidanren*, METI, and JETRO do not currently view the trilateral FTA as an economic priority for Japan. TPP as opposed to RCEP and the China-Japan-South Korea FTA holds priority as TPP negotiations are perceived as delivering regional leveraging power as well as future structural benefits to the Japanese economy. RCEP is prioritized over the trilateral FTA as RCEP is perceived as providing greater FTA trade coverage that will strengthen existing Japanese TNC value-chains. The trilateral FTA, however, from the standpoint of the *Keidanren*, METI, and JETRO, provides identical benefits of providing for FTA trade coverage as RCEP. Yet, both the conclusion of RCEP and the China-Japan-South Korea FTA are contingent on the trajectory of TPP negotiations in order to create a precedent for WTO-plus rules in the region.

**2. Explanation 2: Japanese Agricultural Interest**

The second potential explanation to be tested is if Japanese agricultural interests do not view the trilateral FTA as in their best economic interest, then the China-Japan-South Korea FTA is less likely. For evidence, this explanation will assess the position taken by the biggest and most politically influential Japanese agricultural cooperative, *JA-Zenchu*. Similar to Explanation 1 and the influence of the *Keidanren* on METI, the opinion of the Ministry of Agriculture, Forestry, and Fisheries (MAFF) will be analyzed to see if it follows *JA-Zenchu's* views in regard to the trilateral FTA. Specifically, this section will show that *JA-Zenchu* has a favorable view of the trilateral FTA as a hedge against the TPP, and that such an opinion is shared by MAFF. Due to the similar of opinions between *JA-Zenchu* and MAFF on the utility of the China-Japan-South Korea FTA, Explanation 2 provides little explanatory power for a lack of progress toward the trilateral FTA. The following section will detail the positions taken by *JA-Zenchu* in

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<sup>159</sup> "2014 JETRO Global Trade and Investment Report: On Making Japan a Base for International Business Circulation," 2014.

regard to both the TPP and the trilateral FTA, and then show how MAFF has mirrored *JA-Zenchu*'s position despite recent reforms.

**a. Evidence: JA-Zenchu Position**

**(1) Trilateral FTA as a Hedge Against TPP**

In an opposite position to that of *Keidanren*, the *JA-Zenchu* has been steadfast in its opposition to free trade deals. Similar to *Keidanren*, *JA-Zenchu* views TPP as a major catalyst and has reacted in response to the Japanese government's involvement in TPP. When the Japanese government under the Kan administration considered joining TPP, the then *JA-Zenchu* President made it clear that he was "absolutely against Japan taking part of the TPP."<sup>160</sup> Upon Japan's involvement in TPP negotiations, *JA-Zenchu* President Banzai maintained his group's position that "TPP talks will damage Japan's national interests."<sup>161</sup>

*JA-Zenchu*'s position on the China-Japan-South Korea FTA, unlike *Keidanren*, is much harder to assess through direct comments in open source material. *JA-Zenchu*'s maintains a strict belief that Japanese free trade agreements should have carve-outs for agriculture.<sup>162</sup> Some MAFF officials have voiced support for the China-Japan-South Korea FTA because it would likely exclude agriculture. The exclusion of such agricultural goods would lower the quality of the trilateral FTA. According to an unnamed MAFF official, the trilateral FTA was advantageous in that such an agreement could be "concluded without the complete liberalization of rice and other products."<sup>163</sup> To date, no spokesman for *JA-Zenchu* has come out in support of a trilateral FTA. Yet,

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<sup>160</sup> "State OTMA Daily Summary of Japanese Press for 22 Oct 10" (Open Source Center, October 22, 2010), [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPP20101024057001#index=29&searchKey=18179596&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPP20101024057001#index=29&searchKey=18179596&rpp=10).

<sup>161</sup> "State MATT Japan Morning Highlights 25 Feb 13" (Open Source Center, 25 Feb 13), [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPP20130224035001#index=14&searchKey=18179596&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPP20130224035001#index=14&searchKey=18179596&rpp=10).

<sup>162</sup> See *JA-Zenchu* policy position on TPP: <http://www.zenchu-ja.or.jp/food/tpp>

<sup>163</sup> "Farm Ministry Officials Pinning Hopes on Foundering Japan-PRC-ROK FTA," *Facta*, 01 Jun 12, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPP20120529164002#index=22&searchKey=18179596&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPP20120529164002#index=22&searchKey=18179596&rpp=10).

neither has *JA-Zenchu* come out against the trilateral FTA similar to their opposition to TPP.

Overall, so long as the China-Japan-South Korea FTA does not include significant agricultural tariff lines, this paper assess that *JA-Zenchu* would be supportive of the FTA. TPP negotiations that contain possible compromises to Japanese rice, wheat, dairy, sugar, and pork will sufficiently incentivize *JA-Zenchu* to advocate an alternative FTA.

***b. Evidence: MAFF Opinion of Trilateral FTA***

**(1) Echoing *JA-Zenchu* Position on FTAs**

MAFF's policies have consistently reflected a majority of the positions taken by *JA-Zenchu* that preclude FTAs that threaten Japanese agriculture. Since the LDP took power, MAFF ministers have been supportive of the TPP while maintaining that certain agricultural products—specifically rice, wheat, dairy, and sugar—should be exempted. In May 2013, MAFF Minister Yoshimasa Hayashi, prior to beginning TPP negotiations, made clear that Japan would not “accept the reduction or elimination of the tariff [on rice].”<sup>164</sup> In May 2014, the incoming MAFF minister, Koya Nishikawa, declared that “the TPP is the most important pillar of Mr. Abe’s growth strategy,” but remained firm on protecting most of Japan’s agricultural sectors.<sup>165</sup>

The tenure of Nishikawa in MAFF has led to reforms aimed at *JA-Zenchu* as part of Abe’s structural reform initiative.<sup>166</sup> In February 2015, Nishikawa successfully led the charge against *JA-Zenchu* and removed its authority to audit and guide all Japanese farming cooperatives, removing a coercive tool to influence farmers and collect votes.<sup>167</sup>

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<sup>164</sup> “Farm Minister Says Japan to Place Priority on Rice in TPP Talks,” *Nikkei*, May 1, 2013, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPP20130502173001#index=10&searchKey=18179596&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPP20130502173001#index=10&searchKey=18179596&rpp=10).

<sup>165</sup> Stephen Stapczynski, “Potential Breakthrough in US-Japan TPP Talks Could Make Completing the Trade Pact in 2015 a Reality,” *Izakaya Politics*, accessed February 27, 2015, <http://izakayapolitics.com/2015/01/25/potential-breakthrough-in-us-japan-tpp-talks-could-make-completing-the-trade-pact-in-2015-a-reality/>.

<sup>166</sup> Dermot Gilley, “Can Nishikawa Resolve Japan’s TPP Agricultural Impasse?,” *East Asia Forum*, accessed March 2, 2015, <http://www.eastasiaforum.org/2014/09/09/can-nishikawa-resolve-japans-tpp-agricultural-impasse/>.

<sup>167</sup> “Japan’s Farming Lobby Accepts Cooperatives Reform Plan,” *Reuters*, February 9, 2015, <http://www.reuters.com/article/2015/02/09/japan-farming-idUSL4N0VJ49920150209>.



Nishikawa, however, stepped down at the end of February 2015 in response to allegations of his acceptance of campaign donations from sugar and timber companies.<sup>168</sup> He has been replaced by the previous minister, Yoshimasa Hayashi, who is less capable of countering the influence of *JA-Zenchu*. Despite a recent reformist blip under the tenure of Nishikawa, MAFF policies should continue to reflect *JA-Zenchu* concerns over free trade agreements.

*c. Summary of Evidence and Analysis*

Overall, this section assesses that *JA-Zenchu* and MAFF have articulated similar positions and favor the trilateral FTA under the assumption that it will have carve-outs for sensitive agricultural goods. As both would agree that the trilateral FTA is in the best interest of Japanese agriculture, Explanation 2 does not account for a lack of progress toward the China-Japan-South Korea FTA.

**3. Explanation 3: Japanese Concerns of South Korean Relative Gains in the Chinese Market**

The third potential explanation to be tested is that if Japan is concerned by competition over China's domestic market with South Korean TNCs, then the China-Japan-South Korea FTA is less likely. This explanation will show that while the *Keidanren* are concerned that South Korean TNCs are receiving favorable trade conditions with China, Japanese TNCs are not registering South Korean TNCs as their primary competitor in the Chinese market. Also, Japanese TNC opinions are reflected in recent METI and JETRO White Papers. Due to the lack of competitive threat seen by Japanese TNCs, METI, and JETRO, Explanation 3 does not account for the lack of progress toward a China-Japan-South Korea FTA.

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<sup>168</sup> "Nishikawa Resignation Casts Shadow over Local Elections," *Yomiuri Shimbun*, February 24, 2015, <http://www.the-japan-news.com/news/article/0001958150>.

a. *Evidence: Keidanren's Opinion*

The *Keidanren* has been vocal over its concern that South Korean firms are receiving more favorable trade conditions due to South Korea's success in concluding FTAs. Currently, 18.9% of Japan's trade is covered by FTAs whereas 35.4% of South Korea's trade is covered by trade agreements.<sup>169</sup> When the newly signed China–South Korea FTA is ratified and comes into force, 55.6% of South Korea's trade will be covered by FTAs.<sup>170</sup> The widening gap in coverage has been commented on by *Keidanren* as a potential competitive threat to Japanese overseas business operations. The *Keidanren* began sounding the alarm in 2009 while South Korea was negotiating dual FTAs with the U.S. and E.U. simultaneously.<sup>171</sup> When KORUS negotiations were concluded in 2011, *Keidanren* emphasized the need to sign FTAs with Japan's major markets to prevent a loss of market share due to South Korean competition.<sup>172</sup>

Yet, recent *Keidanren* policy statements on how Japan should redress the Korean FTA advantage does not single out the China-Japan-South Korea FTA as the solution to the Korean competitive advantage in FTAs. While *Keidanren* believes that Japan must improve “access to the Chinese market,” it does not believe that the trilateral FTA will provide the solution to Japan's dearth of FTA coverage.<sup>173</sup> In a 2013 *Keidanren* policy statement, the advocacy group asserted that “TPP participation is essential to redressing the unfavorable competitive conditions Japan faces compared to countries such as South

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<sup>169</sup> “2013 METI White Paper on International Economy and Trade,” METI White Paper (Tokyo, Japan: METI of Japan, June 18, 2014), 9, <http://www.meti.go.jp/english/report/downloadfiles/2013WhitePaper/2-1.pdf>.

<sup>170</sup> Ibid.

<sup>171</sup> Jitsumori Izuru, “South Korea Increasing Drive for FTAs,” *The Daily Yomiuri Online*, June 29, 2009, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPP20090629969106#index=378&searchKey=18155774&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPP20090629969106#index=378&searchKey=18155774&rpp=10).

<sup>172</sup> “Japanese Businesses Fear Impact of U.S.-South Korea FTA,” *Asahi Shimbun Online*, October 15, 2011, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/JPP20111015969012#index=567&searchKey=18155774&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/JPP20111015969012#index=567&searchKey=18155774&rpp=10).

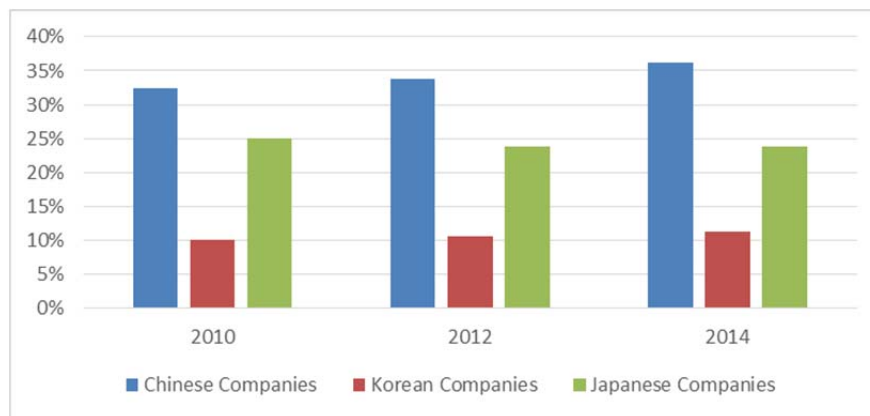
<sup>173</sup> “Proposals for Redefining of Trade Strategy.”

Korea and restoring and enhancing Japan's competitiveness through establishment of trade rules.”<sup>174</sup>

***b. Evidence: Japanese TNCs Opinion***

Unlike the *Keidanren*, however, Japanese TNCs in China have yet to perceive South Korean competition as the most significant threat. Based on surveys from the state-sponsored Japan Bank of International Cooperation (JBIC), only 11% of Japanese TNCs in China viewed South Korean firms as their main competitors in 2014, a 1% increase from 2010 (Figure 3). During this same time period, 36% of Japanese companies viewed domestic Chinese firms as their stiffest competitors in China, a 3% increase from 2010 (Figure 3). When asked to compare effectiveness of sales power in the Chinese market between Japanese and South Korean companies, Japanese firms have showed a decrease in their view of South Korean sales power (Figure 4). In 2014, Japanese companies viewed South Korean competitors as having less sales power than themselves in the Chinese market. Overall, the 2014 JBIC survey confidently concludes that “in sales power evaluation of competitors, Chinese and Korean companies are declining.”<sup>175</sup>

Figure 3. Perception of Intense Competition in Chinese Market by Japanese Businesses



Japanese TNC competition opinion compiled from JBIC Annual Business and Investment Surveys: <http://www.jbic.go.jp/en>.

<sup>174</sup> Ibid.

<sup>175</sup> JBIC, “Results of the JBIC FY2014 Survey” (JBIC, November 2014), 6, [http://www.jbic.go.jp/wp-content/uploads/press\\_en/2014/11/32994/20141128English1.pdf](http://www.jbic.go.jp/wp-content/uploads/press_en/2014/11/32994/20141128English1.pdf).

The low level of perception of South Korean competitive threat and decreasing perception of South Korean competitive sales power by Japanese firms in the Chinese market also decreases the perception that South Korean firms would have greater relative gains than Japanese ones if there were a trilateral FTA. Considering that a China-Japan-South Korea FTA would allow for equal access to the Chinese market among Japanese and South Korea firms, then one can assume that preexisting levels of competition and sales power should be accentuated. Specifically, sales power of either Japanese or South Korean TNCs should be amplified by a trilateral FTA, and thus, increase relative gains in favor of South Korean firms. The decrease in South Korean TNC sales power in China, as noted in Figure 3, indicates that Japanese TNCs would not necessarily view a China-Japan-South Korea FTA as increasing relative gain disparities to the favor of their South Korean counterparts.

**c. Evidence: METI and JETRO Policy Opinion**

JETRO, more so than METI, has articulated similar positions as the *Keidanren* and Japanese TNCs in that Japan suffers from a dearth of competitive FTAs and that South Korean competition is not a motivating factor. The 2014 METI White Paper stated that in light of Japan's consecutive trade deficits, a diminished current account surplus, and lack of FTA coverage, "it is becoming increasingly important to enhance the business environment both within Japan and overseas, in order to bolster the competitiveness of Japanese industry."<sup>176</sup> Yet, official METI position does not indicate that a China-Japan-South Korea FTA takes precedence in addressing these concerns. Similar to *Keidanren*, JETRO sees qualitative differences between TPP and RCEP in that "TPP is oriented toward the establishment of high-level rules, while the RCEP seeks to create a business-friendly framework in aspects such as supply chains."<sup>177</sup>

Neither METI nor JETRO registered any concerns about competition with Korean TNCs in the Chinese market in their 2013 and 2014 white papers. Similar to the 2014

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<sup>176</sup> "2014 METI White Paper: Strengthening Links to the Global Economy via Economic Partnerships."

<sup>177</sup> "2014 JETRO Global Trade and Investment Report: On Making Japan a Base for International Business Circulation," 17.

JBIC survey, the 2014 METI White Paper was confident about the resurgence in Japanese TNC competitiveness, especially in Asia.<sup>178</sup> Besides increased sales in ASEAN, METI focused on the growth of Japanese affiliates in China as an indicator of the robust presence and optimism of Japanese TNCs in China.<sup>179</sup>

*d. Summary of Evidence and Analysis*

Overall, METI and JETRO, similar to Japanese TNCs, do not currently perceive a Korean competitive threat in the Chinese market if a China-Japan-South Korea FTA was concluded. Similar to the *Keidanren*, JETRO and METI do not view the trilateral FTA as redressing South Korea's competitive edge in FTAs. The greatest threat for Japanese TNCs operating in China is not South Korean competitors, but rather, the increase in Chinese domestic competition and the economic slowdown of the Chinese economy as it conducts structural reforms.<sup>180</sup> Thus, a South Korean competitive threat acting as a drag force on the Japanese side of the negotiating table does not account for a lack of progress toward a trilateral FTA.

**4. Explanation 4: Japanese Concern for Political-Historical Animosity**

The fourth potential explanation to be tested is that if historical and political grievances negatively affect the economic relationship between China-Japan-South Korea, then a trilateral FTA is less likely. Japanese TNCs in Northeast Asia have had to operate in an often politically antagonistic environment. Recent antagonisms include riots in China against Japan in 2005 and 2012, the collision of a Chinese trawler and Japanese Coast Guard vessel near the Senkakus in 2010, South Korean protests over Takeshima / Dokdo, and occupation legacy issues with South Korea. This section will argue that Japanese TNCs and the *Keidanren* do not view political-historical animosities as a deal-breaker in the Sino-Japanese economic relationship, but they do view such factors as

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<sup>178</sup> "2014 METI White Paper: Strengthening Links to the Global Economy via Economic Partnerships," 415–8.

<sup>179</sup> "2013 METI White Paper on International Economy and Trade," 416.

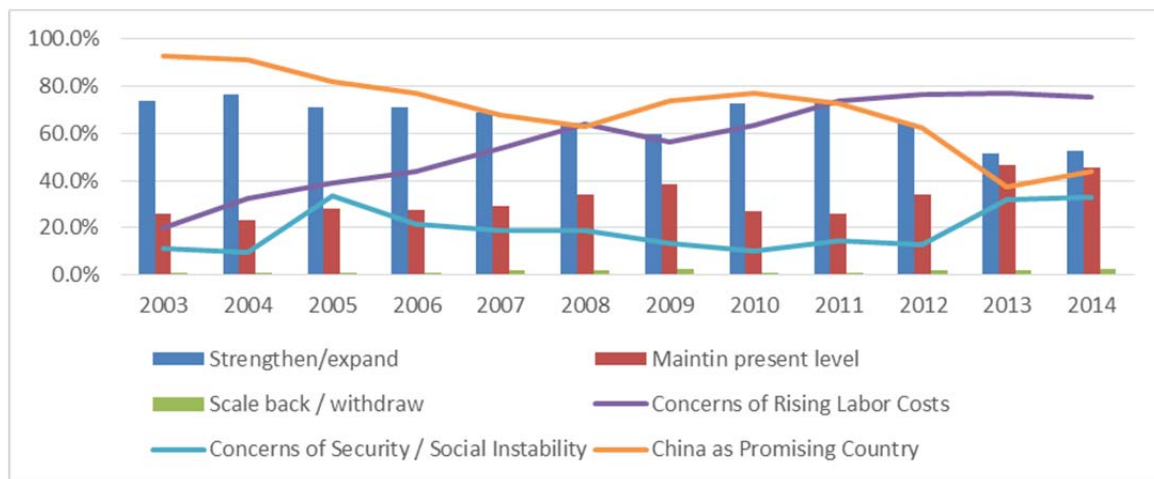
<sup>180</sup> "2014 METI White Paper: Risk Factors" (Tokyo, Japan: METI of Japan, February 20, 2015), 44, <http://www.meti.go.jp/english/report/downloadfiles/2014WhitePaper/1-1-3.pdf>.

having a constraining effect on the Japanese-South Korean economic relationship. The mixed perception of the significance of historical and political grievances in the trilateral relationship makes such grievances a weak explanation for a lack of progress toward the trilateral FTA.

*a. Evidence: Sino-Japanese Relations*

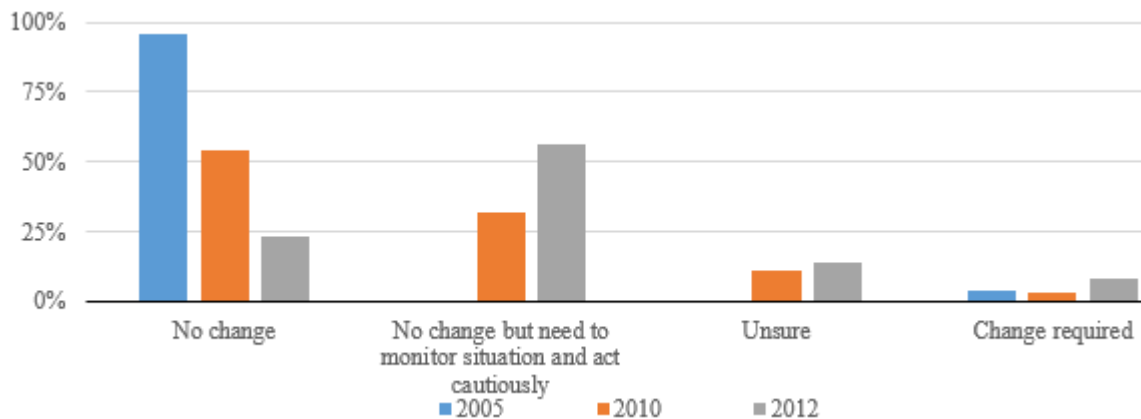
The 2005, 2010, and 2012 Sino-Japanese events that led to heightened tensions between the two countries did not have an appreciable effect on Japanese TNCs ability to do business in China. Surveys by JBIC indicate that Japanese TNCs are more worried about factor-driven concerns than they are about political considerations when determining their three-year, medium term outlook of operations in China (Figure 4). The rising cost of labor in China is more of a concern for Japanese TNCs than political instability even during politically tense years (Figure 4). Additionally, during the specific years of 2005, 2010, and 2012, a majority of Japanese TNCs did not plan to alter their medium term outlook or pull out of China (Figure 5).

Figure 4. Medium Term Prospects for Japanese Overseas Business Operations in China



Medium term Japanese TNC opinion surveys compiled from JBIC Annual Business and Investment Surveys: <http://www.jbic.go.jp/en>.

Figure 5. Effect of Recent Tensions on Three-Year Business Plans in China



Japanese business medium term opinions based on reaction to political events compiled from JBIC Annual Business and Investment Surveys: <http://www.jbic.go.jp/en>.

In addition, the ability of the *Keidanren* to liaison with its counterparts in China has not suffered significantly due to political tensions. Following the 2012 riots, *Keidanren*'s business expos in China were cancelled, however, *Keidanren* was still able to liaison with Chinese officials and business counterparts. Starting in February 2013, *Keidanren* has consistently met with former and current CCP officials as well as Chinese business leaders.<sup>181</sup> Yet, unlike previous Chinese presidents and premiers, neither Xi Jinping nor Li Keqiang have met with the *Keidanren*.<sup>182</sup>

The opinion of the *Keidanren* and Japanese TNCs concerning bilateral relations with China, however, does not match overall Japanese public opinion. In a 2014 Pew Research Center poll of how Asian countries view on another, 68% of Japanese

<sup>181</sup> "Chairman Sakakibara's Statements and Comments at His Press Conference," *Keidanren*, September 29, 2014, <http://www.keidanren.or.jp/en/speech/kaiken/2014/0929.html>; James J. Przystup, "Past as Prologue," *Comparative Connections* 16, no. 1 (May 2014): 11, 14; James J. Przystup, "Treading Troubled Waters," *Comparative Connections* 15, no. 1 (May 2013): 5; James J. Przystup, "Can We Talk?," *Comparative Connections* 15, no. 3 (January 2014): 8; "Chairman Yonekura's Comments at His Press Conference," *Keidanren*, November 11, 2013, <http://www.keidanren.or.jp/en/speech/kaiken/2013/1111.html>.

<sup>182</sup> Stephen Harner, "With Japan-China Political Relations Still Frozen, Japan Business Delegation Gets No Meeting With Xi Or Li, Anti-Monopoly Fines Explained," *Forbes*, September 23, 2014, <http://www.forbes.com/sites/stephenharner/2014/09/23/with-japan-china-political-relations-still-frozen-japan-business-delegation-gets-no-meeting-with-xi-or-li-anti-monopoly-fines-explained/>.

respondents agreed with the claim that China posed the greatest threat toward Japan.<sup>183</sup> On the question of whether or not Sino-Japanese territorial disputes “could lead to a military conflict,” 85% of Japanese respondents registered concern that such a scenario could occur.<sup>184</sup> In regard to the question of whether or not one thinks that “China’s growing economy is a good thing or a bad thing for our country,” 39% of Japanese said it was good for Japan and 47% responded that it was a bad.<sup>185</sup> In terms of whether or not the Japanese public has “confidence in [Chinese President] Xi to do the right thing in world affairs,” a majority of Japanese, 87%, had no confidence.<sup>186</sup> In addition, only 7% of Japanese respondents held favorable views of China.<sup>187</sup> Overall, public sentiment toward China is dramatically opposite from that of Sino-Japanese business sentiment.

***b. Evidence: Japanese–South Korean Relations***

The *Keidanren* has had a mixed experience with the South Korean government and its Korean business counterparts. Following disputes over the issues of comfort women, Takeshima/Dokdo, and occupation reparations, *Keidanren* and the Federation of Korean Industries (FKI) stopped holding their annual summits in 2007 after 23 years of bilateral cooperation.<sup>188</sup> In addition, efforts by citizen’s groups to prosecute Japanese TNCs in South Korean courts for occupation reparations have deepened the divide. A 2013 South Korea Supreme Court ruling ordered Nippon Steel to pay reparations for forced work during the Japanese occupation.<sup>189</sup> The *Keidanren* characterized the ruling

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<sup>183</sup> “Global Opposition to U.S. Surveillance and Drone, but Limited Harm to America’s Image” (Washington, D.C.: Pew Research Center, July 14, 2014), 38, <http://www.pewglobal.org/files/2014/07/2014-07-14-Balance-of-Power.pdf>.

<sup>184</sup> *Ibid.*, 39.

<sup>185</sup> *Ibid.*, 28.

<sup>186</sup> *Ibid.*, 30.

<sup>187</sup> *Ibid.*, 37.

<sup>188</sup> “Japan And Korea Agree To Stronger Business Ties,” *JoongAng Daily Online*, 01 dec 14, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPR2014120159125779#index=807&searchKey=18155774&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPR2014120159125779#index=807&searchKey=18155774&rpp=10).

<sup>189</sup> Jack Kim and Ju-min Park, “South Korea Court Orders Nippon Steel to Pay for Forced Labor,” *Reuters*, July 10, 2013, <http://www.reuters.com/article/2013/07/10/us-korea-japan-idUSBRE9690AE20130710>.



as creating “obstacles” to the Japanese-South Korean economic relationship.<sup>190</sup> The ruling has been followed by another successful case in October 2014 against a Japanese TNC.<sup>191</sup>

The relationship between the *Keidanren* and South Korea has recently normalized. In December 2014, after a seven-year freeze, *Keidanren* and FKI resumed their annual summit and promised to work together toward a China-Japan-South Korea FTA. Following the meeting, the *Keidanren* met with President Park Geun-hye, a first under the Park administration.<sup>192</sup> It would seem that the *Keidanren*’s consistent support for trilateral cooperation toward the China-Japan-South Korea FTA paid its dividends and allowed for the rapprochement between itself and the South Korean government.

Improving relations between the *Keidanren*, FKI, and the South Korean government, however, do not match Japanese public opinion toward South Korea. In a 2015 public opinion poll conducted by Genron NPO concerning Japanese views of South Korea, most Japanese have an unfavorable view of South Korea.<sup>193</sup> According to the poll, 52.4% of Japanese view South Korea unfavorably, while only 23.8% held a favorable view.<sup>194</sup> Of those who held a negative view of South Korea, the top two reasons for such a view was due to South Korean “criticism of Japan over historical issues,” and “continuing confrontation over Takeshima.”<sup>195</sup> In regard to what issues should be a priority for the Japan–South Korea bilateral relationship, only 3.8% of respondents agreed on promoting “how to strengthen cooperative relations on trade and

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<sup>190</sup> “Japan’s Refusal To Face Its Past Spills Over Into Business,” *Chosun Ilbo Online*, November 7, 2013, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPR2013110719272997#index=724&searchKey=18155774&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPR2013110719272997#index=724&searchKey=18155774&rpp=10).

<sup>191</sup> Choe Sang-hun, “South Korean Court Orders Japanese Firm Nachi-Fujikoshi to Pay Forced Laborers,” *The New York Times*, October 30, 2014, <http://www.nytimes.com/2014/10/31/world/asia/nachi-fujikoshi-south-korea-ruling.html>.

<sup>192</sup> “Park: Summit with Abe Hinges on Attitude toward ‘Comfort Women’ Issue,” *Asahi Shimbun*, December 2, 2014, [http://ajw.asahi.com/article/asia/korean\\_peninsula/AJ201412020043](http://ajw.asahi.com/article/asia/korean_peninsula/AJ201412020043).

<sup>193</sup> “The 3rd Japan - South Korea Joint Public Opinion Poll (2015)” (Genron NPO and East Asia Institute, May 2015), [http://www.genron-npo.net/pdf/forum\\_1505\\_en.pdf](http://www.genron-npo.net/pdf/forum_1505_en.pdf).

<sup>194</sup> *Ibid.*, 4.

<sup>195</sup> *Ibid.*, 6.

investment and create a free trade zone.”<sup>196</sup> Despite negative opinions due to historical and territorial claims, nearly half of Japanese surveyed (49.5%) agreed that “economic growth in South Korea is both beneficial and necessary to Japan.”<sup>197</sup> The previous two polls conducted confirm an annual increase in positive views by Japanese that South Korean economic wellbeing is mutually beneficial for the two countries.<sup>198</sup> In addition, 67.8% of Japanese respondents admit that the Japan–South Korea relationship is on the wrong track and the relationship needs to be improved.<sup>199</sup>

*c. Summary of Evidence and Analysis*

Overall, Japanese TNCs and the *Keidanren* do not consider historical and political animosities as serious impediments to the Sino-Japanese relationship, but they have in the recent past seen these animosities as constraining the Japan-South Korea relationship. Sino-Japanese business relations have fared better than Japanese-South Korean business relations, but the latter seems to be on the mend. The *Keidanren* is sensitive to the fluctuations in political-historical grievances and acts as an active intermediary unlike its South Korean and Chinese counterparts. While being able to meet with Chinese officials during periods of heightened political tension seems like a low bar to pass, such an ability to maintain dialogue should be contrasted to that of the *Keidanren* in South Korea over the last eight years. The deep freeze in which the *Keidanren* were placed in South Korea from 2007 to 2014 speaks to the ability of negative public opinion to shape what should be a purely economic relationship. At the same time, the autonomy of the *Keidanren* to show the initiative and meet with their Chinese and South Korean counterparts shows an ability to act despite of negative public opinion at home. This autonomy from negative public opinion is not seen by *Keidanren's* regional partners, especially in regard to *Keidanren's* counterparts in South Korea.

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<sup>196</sup> Ibid., 18.

<sup>197</sup> “The 3rd Japan - South Korea Joint Public Opinion Poll (2015),” 24.

<sup>198</sup> Ibid.

<sup>199</sup> Ibid., 8.

## C. FINAL ANALYSIS AND CONCLUSION

Japan's perception that the China-Japan-South Korea FTA is not an economic priority is one of the strongest drag forces of the four examined on the Japanese side of the negotiating table. The other three explanations do not account for the lack of progress toward the trilateral FTA. So long as the *Keidanren* and METI view TPP as the best deal on the table to reach FTAAP, the China-Japan-South Korea FTA will remain as a lower priority.

In regard to the second explanation of Japanese agricultural interests causing a lack of progress, *JA-Zenchu* and MAFF have common interests and have stated positions that align themselves toward being supportive of the trilateral FTA. This common position is prefaced on the assumption that the China-Japan-South Korea FTA will contain agricultural carve-outs. So long as *JA-Zenchu* remains a politically salient force in Japanese politics, it will influence the FTA decisions currently being made by the LDP administration.

As for the third explanation of Japanese TNCs perceiving a competitive threat from South Korean firms in the Chinese market, the perception of threat is not supported by recent Japanese business opinion surveys. The LDP's Three Arrows program has had a noticeable effect on the optimism of Japanese firms as well as endogenous Japanese business reforms that have increased their overall competitiveness as compared to their Korean counterparts.

Finally, the fourth explanation of political-historical animosities to cause the Japanese to drag their feet on the trilateral FTA has actually had the opposite effect. The activity and the willingness to cooperate trilaterally by the *Keidanren* has been driven in part by an attempt to overcome political-historical divides. The *Keidanren* have acted as middlemen for Japan between China and South Korea when relations have soured despite of poor public perceptions of China and South Korea at home. Additionally, Japanese TNCs have not registered negative impacts on business operations in either China or South Korea due to flare-ups in tensions.

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## **IV. SOUTH KOREA: LACK OF PROGRESS DUE TO POLITICAL AND HISTORICAL GRIEVANCES**

### **A. INTRODUCTION**

Since 2001, South Korea has pursued an aggressive government-led policy of simultaneous, bilateral trade negotiations that now covers 61% of all South Korean trade.<sup>200</sup> South Korea has also attempted to join the various mega-regional FTAs that are being negotiated in the Asia-Pacific as part of its overall FTA policy of turning South Korea into the FTA lynchpin of the Asia-Pacific. South Korea's policy has resulted in FTAs with all of its major trading partners—ASEAN, U.S., E.U., and China—excepting Japan. Negotiations for a bilateral Japan-South Korea FTA in 2004 and 2005 floundered during an intense period of anti-Japanese sentiment in South Korea. Such sentiment has continued to be an influential force in South Korean domestic politics as well as in the Japan-South Korea bilateral relationship. While examining the four potential explanation for a lack of progress toward a China-Japan-South Korea FTA—which include South Korean perceptions of economic priority, domestic interests, foreign business competition, and political-historical grievances—this chapter will show that political and historical animosities still remain the strongest reason for a lack of progress toward a trilateral FTA that involves Japan.

### **B. EVIDENCE AND ANALYSIS**

As detailed in Chapter I, there are four potential explanations that would cause each country to accept a lack of progress toward a China-Japan-South Korea FTA. This section will outline each of these four explanations that potentially motivate South Korea in pursuing the trilateral FTA.

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<sup>200</sup> “2013 METI White Paper on International Economy and Trade,” 9.

## **1. Explanation 1: South Korea Economic Priority**

The first potential explanation to be tested is if South Korea does not view the trilateral FTA as an economic priority, then the China-Japan-South Korea FTA is less likely. For evidence, this explanation will assess the positions taken by South Korean business advocacy groups, Federation of Korean Industries (FKI) and the Korean Industry Trade Association (KITA). On the government side, positions taken by the Ministry of Foreign Affairs (MoFA) and Ministry of Trade, Industry, and Energy (MoTIE) will be assessed. Specifically, this section will show that neither FKI, KITA, MoFA, nor MoTIE view the trilateral FTA as an economic priority. In order to assess the opinion of these various actors, the following section will outline potential benefits that should entice these actors and show that none of these actors view those benefits as sufficient when compared to their interest in other mega-FTAs, such as TPP and RCEP.

### ***a. Evidence: FKI and KITA Position on Trilateral FTA***

#### **(1) Support for an FTA with Japan to Affect Structural Change**

A potential motivation for South Korean business groups and government to pursue a trilateral FTA is the potential to combat significant structural problems, such as labor market efficiency, and keep Japanese-styled secular stagnation at bay, all of which are issues identified by these actors. In a December 2014 survey by FKI of Korean economists, fears of secular stagnation were on the minds of the majority South Korean economists and academics.<sup>201</sup> An additional 2014 survey by FKI of domestic businesses reported that 86% believe that Korean “manufacturing and export[s] were trapped in a structural crisis.”<sup>202</sup>

According to some South Korean economic think-tanks, an FTA with Japan could combat structural problems and avoid secular stagnation by increasing Korean TNC efficiency and competitiveness. According to a 2012 Korean Institute for Economic Policy

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<sup>201</sup> “Issues and Management Conditions for the Korean Economy in 2015” (Seoul, South Korea: Federation of Korean Industries, December 15, 2014), [http://www.fki.or.kr/en/Research/View.aspx?content\\_id=b959c619-2e22-473f-a7a6-dc3746c2ac57&cPage=1&search\\_type=0&search\\_keyword=](http://www.fki.or.kr/en/Research/View.aspx?content_id=b959c619-2e22-473f-a7a6-dc3746c2ac57&cPage=1&search_type=0&search_keyword=).

<sup>202</sup> Ibid.

(KEIP) statement concerning the trilateral FTA, such an FTA regardless of various levels of tariff liberalization would “benefit [South Korea] immensely, more than China or Japan” by lowering trade barriers with Japan.<sup>203</sup> Additionally, the KEIP analysis pointed out that any FTA with Japan would benefit the “petrochemical, machinery, and electronics sectors of the South Korean economy.”<sup>204</sup> In a 2013 KEIP working paper concerning a Japan-South Korea FTA, KEIP stressed that an FTA with Japan would address some of South Korea’s structural problems as well as allow Korea to enjoy “greater benefits from trade by exploiting the larger foreign market (market size) as well as consuming cheaper imports [from Japan].”<sup>205</sup>

## (2) FKI and KITA Lack of Support for Trilateral FTA

Despite KEIP support for a China-Japan-South Korea FTA that could address South Korea’s structural problems, FKI and KITA have not enthusiastically supported the trilateral FTA. Unlike their *Keidanren* peers in Japan, FKI and KITA have not been vocal about supporting a trilateral FTA. Outside of trilateral and bilateral meetings with the *Keidanren* listed in Chapter III, FKI and KITA have not vocally advocated for the China-Japan-South Korea FTA on their own in South Korean media. Rather, FKI and KITA have been focused on the newly signed China-South Korea FTA.<sup>206</sup> The silence on the issues of the trilateral FTA by FKI and KITA is deafening when compared to their Japanese counterparts.

The silence concerning the trilateral FTA reflects FKI’s and KITA’s own understanding of which FTAs South Korean businesses prioritize. In a 2012 survey of FKI member firms’ positions on which FTA South Korea should prioritize, only 3.9%

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<sup>203</sup> “Analysts Expect Northeast Asian Countries FTA Talks to Boost Trade, Economy,” *Yonhap News*, November 20, 2012, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPP20121120971093#index=4&searchKey=18797530&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPP20121120971093#index=4&searchKey=18797530&rpp=10).

<sup>204</sup> Ibid.

<sup>205</sup> Gihoon Hong and Soo Hyun Oh, “Gains from Trade Liberalization between Heterogeneous Countries: Implications for Korea-Japan FTA,” *Korea Institute for International Economic Policy*, Working Papers, December 30, 2013, 26.

<sup>206</sup> “South Korean Firms Support FTA With China: Biz Group,” *Yonhap News*, July 2, 2013, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPP20130702971073#index=28&searchKey=18226942&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPP20130702971073#index=28&searchKey=18226942&rpp=10).

chose the trilateral FTA.<sup>207</sup> In a March 2015 survey, KITA found that its members were acutely concerned that given the progress of TPP negotiations and the probability of the U.S. Congress granting President Barack Obama Trade Promotion Authority (TPA), that TPP should be South Korea's main concern.<sup>208</sup> Such a concern is based from KITA's own statistics that TPP would integrate countries that account for 69% of South Korea's export market and 44.4% of its outward FDI.<sup>209</sup> Following the U.S. Congress granting President Obama TPA in June 2015, KITA published a survey that found 62.2% of South Korean businesses supported joining the TPP.<sup>210</sup> One of the main concerns that these businesses held if they did join TPP was "that the opening of local markets to Japan could hurt businesses overall."<sup>211</sup> Indeed, South Korean businesses are registering increasing Japanese competitiveness in countries such as the U.S. and China despite Japan not having FTAs with these countries.<sup>212</sup>

Beyond the lack of public statements by FKI and KITA, their own internal think-tanks indicate a lack of support for the trilateral FTA despite being supportive of the South Korean government's FTA-creation policy. In a 2014 policy review by a KITA think-tank of the government's new 2013 Trade Roadmap, KITA agreed with the government's belief that South Korea needed "to play a pivotal role in the economic integration of East Asia with its FTAs with both the United States and China" by ensuring that South Korea becomes the link between RCEP and TPP.<sup>213</sup> The policy review, however, does not explain how the trilateral FTA would complement the South

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<sup>207</sup> "Positive Effects of FTA Confirmed Amid Global Economic Recession, Persistent FTA Propulsion Is Necessary" (Seoul, South Korea: Federation of Korean Industries, October 11, 2012), [http://www.fki.or.kr/en/research/View.aspx?content\\_id=c275acae-925e-4d1a-bdf9-e975a865a823&cPage=5&search\\_type=0&search\\_keyword=](http://www.fki.or.kr/en/research/View.aspx?content_id=c275acae-925e-4d1a-bdf9-e975a865a823&cPage=5&search_type=0&search_keyword=).

<sup>208</sup> "High Possibility of Reaching the TPP Agreement in the 1st Half of This Year, Korea Needs to Be Prepared" (Seoul, South Korea: Korean International Trade Association, April 1, 2015), [http://www.kita.org/engapp/board\\_view.jsp?no=1741&grp=S3&code=S3021](http://www.kita.org/engapp/board_view.jsp?no=1741&grp=S3&code=S3021).

<sup>209</sup> Ibid.

<sup>210</sup> "Over 60 Pct of S. Korean Firms Back Joining in U.S.-Led Trade Deal: Poll," *Yonhap News*, June 25, 2015.

<sup>211</sup> Ibid.

<sup>212</sup> "Export Competition Between Korea and Japan Is Getting Fiercer in the U.S. Import Market" (Seoul, South Korea: Korean International Trade Association, July 3, 2015), <http://www.kita.org/>.

<sup>213</sup> Jin-ho Myoung et al., "The Decade-Long Journey of Korea's FTAs," *Institute for International Trade, Trade Focus*, 13, no. 18 (June 30, 2014): 18.



Korean government's approach of making South Korea into a strategic hub between the U.S. and China. Rather, the KITA review takes an adversarial tone with Japan in that "Japan has set out to beat Korea in this game" of being the lynchpin of Asia-Pacific FTAs.<sup>214</sup>

***b. Evidence: MoTIE and MoFA Stance toward China-Japan-ROK FTA***

**(1) Focus on RCEP and TPP Instead of Trilateral FTA**

In regard to the official South Korean view of the China-Japan-South Korea FTA, MoTIE and MoFA have prioritized RCEP and TPP participation over the trilateral FTA as part of its overall FTA strategy to become a regional hub for the new mega-FTAs forming in the Asia-Pacific. A 2013 MoTIE White Paper explained South Korea's new approach to FTAs in which the importance of mega-regional trade deals, TPP and RCEP, were emphasized.<sup>215</sup> MoTIE envisioned that South Korea would not only serve as a hub for FTAs but also as a bridge between the American-led TPP, and what the South Korean's view as the Chinese dominated RCEP. The China-Japan-South Korea FTA would serve as an "institutional foundation for an East Asian Community."<sup>216</sup> Yet, the trilateral FTA is framed as falling underneath the architecture of RCEP in the 2013 MoTIE White Paper.<sup>217</sup> Additionally, a December 2014 MoTIE sponsored conference on South Korean trade policy made little mention of the trilateral FTA.<sup>218</sup> The China-Japan-South Korea FTA was grouped together as one of many approaches to achieving mega-FTAs in the Asia-Pacific and, the conference papers focused on the prospective economic gains from TPP, RCEP, and the China-South Korea FTA—not the trilateral FTA.<sup>219</sup>

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<sup>214</sup> Myoung, "The Decade-Long Journey of Korea's FTAs," 43.

<sup>215</sup> "The New Government Trade Roadmap" (Seoul, South Korea: Ministry of Trade, Industry, and Energy, June 14, 2013), [http://www.motie.go.kr/motie/ne/presse/press2/bbs/bbsView.do?bbs\\_seq\\_n=78026&bbs\\_cd\\_n=81](http://www.motie.go.kr/motie/ne/presse/press2/bbs/bbsView.do?bbs_seq_n=78026&bbs_cd_n=81).

<sup>216</sup> In annex of Ibid., 5.

<sup>217</sup> "The New Government Trade Roadmap."

<sup>218</sup> "2014 Seoul Conference on Trade and Industry" (Seoul, South Korea: Korea Institute for International Economic Policy, December 8, 2014), [http://www.kiep.go.kr/eng/seminars/sem01\\_view.jsp?no=185591](http://www.kiep.go.kr/eng/seminars/sem01_view.jsp?no=185591).

<sup>219</sup> 2014 Seoul Conference on Trade and Industry.

*c. Summary of Evidence and Analysis*

Overall, FKI, KITA, MoTIE, and MoFA do not view the trilateral FTA as an economic priority for South Korea when compared to the other mega-FTAs. These views make the potential explanation of economic priority a strong reason for a lack of progress toward a trilateral FTA. Despite the economic gains and structural reform that could be gained from a China-Japan-South Korea FTA, FKI and KITA have avoided making firm commitments to a trilateral FTA and are more interested in TPP. Yet, FKI and KITA are not interested in the trilateral FTA not because of a lack of economic benefits, but rather, they seem not interested despite the economic benefits. This is all the more puzzling considering that these business groups' own think-tanks support South Korea's robust FTA program of making South Korea a hub for East Asian FTAs.

As for MoTIE and MoFA, the trilateral FTA has been subordinated by a desire to be a lynchpin for the newly forming TPP and RCEP mega-FTAs. Their interest in these other mega-FTAs reduces the priority of the trilateral FTA.

**2. Explanation 2: South Korean Agricultural Interest**

The second potential explanation to be tested is if South Korean agricultural interests do not view the trilateral FTA in their best economic interest, then the China-Japan-South Korea FTA is less likely. This explanation will assess that the largest and most politically influential agricultural NGO, the Korean Peasant's League (KPL), has never had the ability to successfully block the progress of the South Korean government's aggressive FTA creation policy launched in 2001 despite vocally, and often violently, opposing FTAs. Past ratification of FTAs since 2001 has shown that the South Korean government has sufficient capacity to mollify a majority of Korean agricultural interest groups, including the KPL, through subsidies and NTBs in order to ensure FTAs are ratified through the South Korean legislature. Thus, KPL's view that the China-Japan-South Korea FTA is not in South Korea's best economic interest is not a causally strong explanation for the trilateral FTA to be less likely. For evidence, the section will establish

how the South Korean government successfully appeases agricultural interest groups that are vehemently opposed to free trade.

***a. Evidence: South Korean Government's Ability to Placate Agricultural Interests***

According to the South Korean government, the China-South Korea FTA, once ratified, is expected to hit the South Korean agricultural sector hard. According to government statistics reported by South Korean media, the bilateral FTA with China is expected cause South Korean agricultural output to be “cut by an annual average of 7.7 billion won (U.S. \$9.64 million) and 10.4 billion won (\$9.37 million) over the next 20 years.”<sup>220</sup> These losses will occur despite the fact that staple crops such as rice and soybeans are excluded from tariff elimination in the FTA.<sup>221</sup> The absence of these agricultural goods in the bilateral FTA exemplify the overall low quality of the China-South Korea FTA. In response, the South Korean government has promised farming interests groups further state support in the form of subsidies to the tune of nearly a billion U.S. dollars over the next 20 years.<sup>222</sup> These subsidies are an addition to the numerous NTBs created by the South Korean government to insulate its agricultural sector.<sup>223</sup>

The ability to financially placate groups such as the KPL has reduced opponents to free trade, which has in turn allowed for the success of the South Korean government to sign and ratify FTAs with larger agricultural countries such as the E.U. and United States. In addition, the ability to sign such agreements in rapid succession starting in 2001

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<sup>220</sup> “Governmentt Submits Bills On Ratification Of New FTAs With China, Vietnam, New Zealand,” *Yonhap News*, June 5, 2015, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPR2015060517516279#index=3&searchKey=19538696&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPR2015060517516279#index=3&searchKey=19538696&rpp=10).

<sup>221</sup> “For Korean Food Exports, FTA A Recipe For Success,” *JoongAng Daily Online*, March 18, 2015, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPR2015031858817251#index=25&searchKey=19539658&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPR2015031858817251#index=25&searchKey=19539658&rpp=10).

<sup>222</sup> “Government Submits Bills On Ratification Of New FTAs With China, Vietnam, New Zealand.”

<sup>223</sup> Im Jeongbin and Jeong Iljeong, “The Frame of Agricultural Policy and Recent Major Agricultural Policy in Korea” (Taipei, Taiwan: The Council of Agriculture, June 2014), [http://ap.ftic.agnet.org/files/ap\\_policy/265/265\\_1.pdf](http://ap.ftic.agnet.org/files/ap_policy/265/265_1.pdf).

shows how the South Korean government has more capacity than the Japanese government to overcome agricultural interests. This capacity is best exemplified by the government's willingness to placate the KPL during the ratification process of the Chile-South Korea FTA in 2004. Similar to the currently proposed measures to offset agricultural losses expected by the China-South Korea FTA, the then government of Roh Moo-hyun compromised with the KPL's political allies in the South Korean legislature and created countervailing subsidies to offset the effects of the Chile-South Korea FTA.<sup>224</sup> As noted by Milner and Mansfield, the South Korean government has become adept at mollifying groups such as KPL in order to ratify FTAs.<sup>225</sup>

***b. Summary of Evidence and Analysis***

Overall, agricultural interests such as the KPL do not possess the same veto power to FTAs as does *JA-Zenchu* in Japan. The South Korean government has become adept at meeting the demands of Korean farmers in a quid-pro-quo relationship of subsidies in exchange for compliance. The current subsidies proposed by the South Korean government as well as the built-in protections for certain agricultural sectors in the China-South Korea FTA indicate that, once again, Korean agricultural interests are being placated. Yet, these interests are being placated at the expense of the South Korean budget as well as at the expense of the quality of the China-South Korea FTA. Thus, so long as the South Korean government continues to have the ability financially buy-off agricultural interests and maintain WTO-lite provision for agricultural goods, then there should be little resistance by agricultural opponents of free trade to the China-Japan-South Korea FTA.

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<sup>224</sup> Mansfield and Milner, *Votes, Vetoes, and the Political Economy of International Trade Agreements*, Location 1463.

<sup>225</sup> Ibid.

### **3. Explanation 3: South Korean Concerns of Relative Gains in the Chinese Market**

The third potential explanation to be tested is that if South Korea is concerned by competition over China's domestic market with Japanese TNCs, then the China-Japan-South Korea FTA is less likely. This explanation will show that FKI and KITA are concerned that South Korean TNCs face stiff competition from Japanese firms but that MoTIE and MoFA only somewhat share the same concerns, thus making the explanation a weak causal argument for a lack of progress. Specifically, FKI and KITA have registered concerns about Japanese competitiveness and adaptability in both the home and Chinese market. Evidence for MoTIE and MoFA not quite sharing the same concerns will be taken from other South Korean FTAs including the recently negotiated China-South Korea FTA.

#### ***a. Evidence: FKI and KITA fears of Japanese Competitiveness***

##### **(1) FKI Competition Concerns during Japan-South Korea FTA**

During the negotiations for the previously stalled Japan-South Korea FTA, FKI complained that many South Korean sectors—other than agriculture—would suffer from direct Japanese competition. According to the FKI in 2004, “such a deal could damage Korea's electronic, automobile, machinery and petrochemical industries,” which is a view in direct opposition to the one held by KIEP in Explanation 1.<sup>226</sup> Essentially, the Japanese could out-compete their South Korean counterparts in both the Japanese and South Korean markets if tariffs were eliminated for those sectors.

##### **(2) FKI and KITA Concerns over Trade Balance**

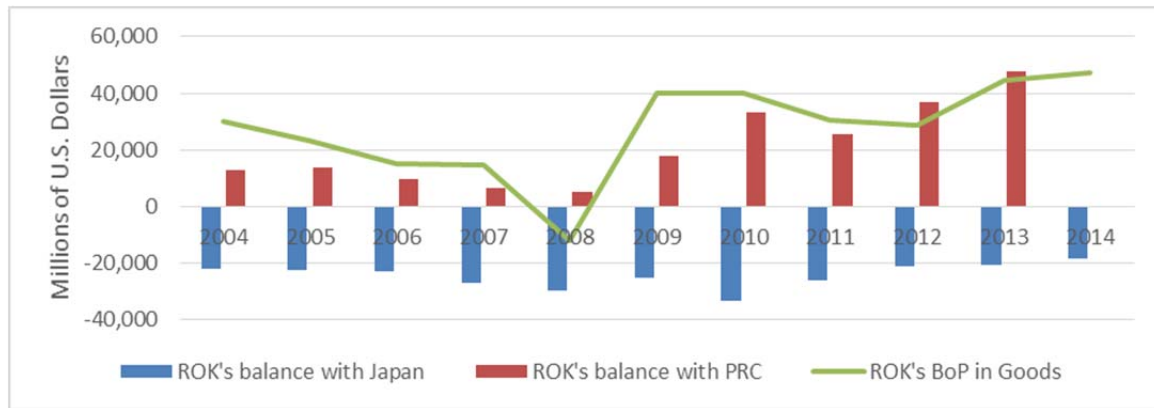
The perception of Japanese firms out-competing South Korean firms is reinforced by the trade balance between the two countries over the last decade. South Korea has continued to run a negative balance of payments in traded goods with Japan despite

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<sup>226</sup> “South Korea Industry Group Expresses Concern over Japan FTA,” *ICIS News*, July 16, 2004, <http://www.icis.com/resources/news/2004/07/16/597024/s-korea-industry-group-expresses-concern-over-japan-fta/>.

running an overall positive balance of payments in traded goods with other countries (Figure 6).

Figure 6. South Korea Balance of Payments in Traded Goods



South Korea's balance of payments in traded goods from World Bank–WITS. No data for 2014 China-South Korea trade balance derived from World Bank, "Korea, Rep. Trade Summary 2013," *World Integrated Trade Solution*, accessed October 29, 2014, <http://wits.worldbank.org/CountryProfile/Country/KOR/Year/2013/Summary>.

The South Korea-Japan trade balance also reflects qualitative differences between Japanese and Korean TNCs that feed FKI and KITA perceptions of being out-competed by their Japanese peers. As of 2010, South Korea only counted on two TNCs among the world's top 100 non-financial corporations, the most competitive being Samsung in terms of foreign sales.<sup>227</sup> Japan has eight TNCs competing against Korean firms in similar industries as well as five of the top 50 financial TNCs that have a 2010 U.S. dollar valuation of \$5.8 trillion.<sup>228</sup> Japanese TNCs are also seen by their South Korean counterparts as being able to out-invest Korean firms in China.<sup>229</sup> This allows Japanese firms to establish production as well as sales bases in these growing economies and receive greater market share. These qualitative difference feed into a Korean perception that Japan is their greatest trade competitor, not China. As one Korean economic

<sup>227</sup> Japan and ROK FDI profiles from UNCTAD, "Foreign Direct Investment Country Fact Sheet" (United Nations Conference on Trade and Development), accessed March 15, 2015, <http://unctad.org/en/Pages/DIAE/World%20Investment%20Forum/Search-by-countryeconomy.aspx>.

<sup>228</sup> Ibid.

<sup>229</sup> UNCTAD, "Foreign Direct Investment Country Fact Sheet."

commentator in 2014 remarked, “the dominant view is that Korea could suffer big time if a free trade pact is signed with Japan.”<sup>230</sup>

### (3) FKI and KITA Concerns for Competition in Chinese Market

In regard to operations in China, FKI and KITA have registered challenges for Korean firms as well as the slowness of Korean firms’ response to these challenges when compared to their Japanese counterparts. Many of these challenges include rising local Chinese competition and higher labor costs.<sup>231</sup> There is also the fear that Japanese TNCs has diversified their presence in the Chinese market whereas South Korean TNCs have focused a majority of its exports on a few products.<sup>232</sup> FKI and KITA are wary of an upsurge in Japanese product competitiveness. According to the LG Economic Research Institute, this upsurge can be attributed to Japanese PM Shinzo Abe’s Three Arrow reform program that has reduced the “role of direct industry promotion policy in favor of improvements to the business environment.”<sup>233</sup> These Japanese structural changes are causing Hyundai, LG, Samsung, and POSCO to view that they are losing global market share to resurgent Japanese firms, which could be compounded by a FTA with Japan.<sup>234</sup>

Furthermore, there is a perception advocated by KITA that South Korean TNCs are behind the curve in reacting to changes in the Chinese domestic market in that South Korean companies still use China for third-party production instead of selling directly to the domestic market. According to KITA, Korean value-added trade to China meant for final third-party export accounted for 47.7% of all South Korean exports to China—

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<sup>230</sup> Nam Jeong-ho, “What TPP Really Represents,” *JoongAng Daily Online*, January 13, 2014, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPL2014011357067618#index=22&searchKey=18226942&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPL2014011357067618#index=22&searchKey=18226942&rpp=10).

<sup>231</sup> “South Korean Firms Upbeat About Prospects In China This Year,” *Yonhap News*, January 6, 2014, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPL2014010622257010#index=24&searchKey=18226942&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPL2014010622257010#index=24&searchKey=18226942&rpp=10).

<sup>232</sup> Ibid.

<sup>233</sup> “Policies Need To Go Back To Times Of ‘Catch Up,’” *Hankyoreh Online*, October 29, 2014, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPR2014102931815319#index=17&searchKey=18227179&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPR2014102931815319#index=17&searchKey=18227179&rpp=10).

<sup>234</sup> “Korean Firms Falter Amid Rising Counterparts Of China, Japan,” *Dong-A Ilbo Online*, 21 Jul 14, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPR2014072169628945#index=28&searchKey=18227179&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPR2014072169628945#index=28&searchKey=18227179&rpp=10).

higher than Taiwan.<sup>235</sup> Only 31.7% of Japanese exports to China were part of the value-added trade and exports have continued to decline as Japanese TNCs are reshoring to Japan.<sup>236</sup> The focus on value-added, rather than final product trade, makes South Korean exports more sensitive to the economic restructuring occurring in China as China shifts focus away from an export-driven economy.

(4) Summary of FKI and KITA Concerns

Overall, there is a view among FKI and KITA that Japanese TNCs are more competitive than South Korean TNCs in the Chinese markets and potentially in the Korean home market. As established in Explanation 1, FKI and KITA do not agree with the KEIP view that free trade with Japan can boost South Korean TNC competitiveness. Thus, KITA and FKI do not want an open and balanced playing field in the Chinese or South Korean market with their Japanese peers.

*b. Evidence: MoTIE and MoFA Views of Korean Competitiveness*

(1) Mixed Concern for South Korean TNCs

While KITA and FKI are sensitive to competing with Japanese TNCs in the Chinese market, the South Korean government through MoTIE and MoFA have somewhat registered the same sensitivities. The conclusion of KORUS and the EU-South Korea FTAs indicate that the South Korean government is more than willing to open its home industries up to direct competition in WTO-plus FTAs with Western firms. However, the same cannot be said for the recently signed China-South Korea FTA. The protected sectors in the China-South Korea FTA match those sectors threatened, according to FKI, by a potential Japan-South Korea FTA.<sup>237</sup>

If one were to assume that the South Korean government was concerned about the competitiveness of its TNCs operating in the Chinese market, then one should expect the

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<sup>235</sup> “South Korean Exports To China In A Whole Lot Of Trouble,” *Hankyoreh Online*, August 4, 2014, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPR2014080431233683#index=116&searchKey=18227390&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPR2014080431233683#index=116&searchKey=18227390&rpp=10).

<sup>236</sup> Ibid.

<sup>237</sup> Ministry of Trade, Industry, and Energy, “China- Korea FTA.”



China-South Korea to have had eliminated tariffs for industrial sectors that would have been threatened by a Japan-South Korea FTA in order to receive preferential access not yet conferred to the Japanese. Yet, The China- Korea FTA has a 91% tariff elimination rate and includes large sector carve-outs and prolonged tariff elimination schedules on both sides for automobiles, agriculture, intermediate consumer goods, light industrial products, and refined petroleum products—many of the same sectors that were at issue for FKI during the Japan-South Korea FTA negotiations. These carve-outs overlap with many of the South Korea’s main export products as well as politically sensitive industries. In regard to automobiles, the China-South Korea FTA avoided tariff liberalization “as both countries say the FTA may do more harm than good for their respective carmakers.”<sup>238</sup> For the Korean auto sector, the aversion to tariff liberalization may be driven by a fear of the Korean market being flooded by Chinese manufactured Japanese cars. Thus, the desire for protectionism at home from intrusion of Japanese products produced in China seems to have more of a pull than increasing a South Korean competitive edge through preferential tariff elimination. Although, it is also entirely possible that the tariff barriers still in place in the China-South Korea FTA reflect Chinese sensitivities over their own industries being subject to direct competition with South Korean firms. Overall, it is difficult to determine to what degree the South Korean government is concerned by direct Japanese competition in the Chinese market.

*c. Summary of Evidence and Analysis*

KITA and FKI perceive Japanese TNCs as being able to out-compete their South Korean peers in the Chinese market as well as the Korean home market. While signing WTO-plus FTAs with the U.S. and E.U., MoTIE and MoFA have somewhat balanced business groups’ protectionist desires with the need to gain more market access. Yet, the China-South Korea FTA indicates that such a balance only goes so far and that possible intrusion of Japanese TNCs from Chinese subsidiaries maybe a bridge too far. Overall, given the mixed nature of the government’s approach to South Korean FTAs, concern

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<sup>238</sup> “South Korea’s Biz Community ‘Welcomes’ FTA With China,” *Yonhap News*, 10 Nov 14, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/KPR2014111030338717#index=9&searchKey=18226942&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/KPR2014111030338717#index=9&searchKey=18226942&rpp=10).

over Japanese competition in the Chinese market is a weak explanation for the lack of progress toward a China-Japan-South Korea FTA.

#### **4. Explanation 4: South Korean Concern for Political-Historical Animosity**

The fourth potential explanation to be tested is that if historical and political grievances negatively affect the economic relationship between China and Japan, then a trilateral FTA is less likely. This section will show that political and historical animosities have affected Japanese-Korean economic relationship and continues to act as a drag force on the trilateral FTA, and thus, has the strongest causal strength in inhibiting progress. Evidence for this position is taken from instances of high Japanese-South Korean tension from 2005 to the present. Two relationships will be examined, the state-to-state relationship of track-one level cooperation, and the business-to-business relationship of FKI-KITA interaction with the *Keidanren*. Specifically, the ability of each of these relationships to maintain consistent or growing patterns of interaction despite flare-ups of political-historical-territorial grievances will be assessed. In particular, the example of the Japan-South Korea bilateral FTA will be examined to see if these grievances caused that FTA to be ultimately scuttled or did more prosaic issues create an enduring deadlock.

##### ***a. Evidence: Failure of the Business-to-Business Relationship***

Historical and political animosities have bled into the Japan-South Korea business to business relationship. As detailed in Chapter III, efforts by citizen's groups to prosecute Japanese TNCs in South Korean courts for occupation reparations have deepened the divide. A 2013 South Korea Supreme Court ruling ordered Nippon Steel to pay reparations for forced work during the Japanese occupation.<sup>239</sup> The *Keidanren* characterized the ruling as creating "obstacles" to the Japanese-South Korean economic

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<sup>239</sup> Kim and Park, "South Korea Court Orders Nippon Steel to Pay for Forced Labor."

relationship.<sup>240</sup> The ruling has been followed by another successful case in October 2014 against a Japanese TNC.<sup>241</sup>

These animosities caused a prolonged disjuncture in the ability of FKI and KITA to liaison with their Japanese counterparts, the *Keidanren*. Following disputes over the issues of comfort women, Takeshima/Dokdo, and occupation reparations, *Keidanren* and the FKI stopped holding their annual summits in 2007 after 23 years of bilateral cooperation.<sup>242</sup> After a seven-year freeze, *Keidanren* and FKI resumed their annual summit in December 2014 and promised to work together toward a China-Japan-South Korea FTA. Following the meeting, the *Keidanren* met with President Park Geun-hye, a first under the Park administration.<sup>243</sup>

Of particular note is the meeting between President Park Geun-hye and the *Keidanren*, the first meeting of its kind in the last 10 years by the *Keidanren* in South Korea. According to the *Keidanren*, the purpose of the meeting was “to set up a summit meeting [between Prime Minister Shinzo Abe and Park].”<sup>244</sup> This shows a proactive stance by the *Keidanren* on mending relations between South Korea and Japan. Yet, there has been no reciprocal visit by FKI or KITA to Japan in order to meet with Abe.

Overall, the business-to-business relationship is a one sided affair with the *Keidanren* acting as intermediaries and FKI-KITA as passive actors. Furthermore, the lack of reciprocity on the part of FKI-KITA and its willingness to involve themselves in political-historical charged arguments indicate a lack of concern for maintain the business to business relationship on even keel despite flare-ups of popular and political opinion.

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<sup>240</sup> “Japan’s Refusal To Face Its Past Spills Over Into Business.”

<sup>241</sup> Sang-hun, “South Korean Court Orders Japanese Firm Nachi-Fujikoshi to Pay Forced Laborers.”

<sup>242</sup> “Japan And Korea Agree To Stronger Business Ties.”

<sup>243</sup> “Park.”

<sup>244</sup> Kiyohide Inada, “Keidanren Delegation to Meet with S. Korean President on Dec. 1,” *Asahi Shimbun*, November 29, 2014, [http://ajw.asahi.com/article/behind\\_news/politics/AJ201411290024](http://ajw.asahi.com/article/behind_news/politics/AJ201411290024).

***b. Evidence: Failure of the State-to-State Relationship***

In regard to the state-to-state relationship between South Korea and Japan, there has been a steady decrease in track-one executive and ministerial meetings since the first flare-up over Dokdo/Takeshima and Japanese history textbooks in 2005 (Figure 7). The decrease, however, has corresponded with the establishment of trilateral summits that have nestled Japanese and South Korean diplomatic activity under singular venues. From 2005 to 2012, Japan and South Korean executive leaders met consecutively despite the slow burn of territorial and historical grievances. Yet, rhetoric from South Korean presidents in concern of presumed Japanese transgressions against South Korea have been vocal. In 2006, President Roh Moo-hyun described Japanese maritime activity in the vicinity of Dokdo/Takeshima as “an act that insults Korea’s sovereignty and national pride,” and “an act of asserting the legitimacy of Japan’s criminal history of waging wars of aggression.”<sup>245</sup> Following the second Dokdo/Takeshima flare-up in 2012, the newly elected President Park vowed to not meet Abe until the historical and territorial grievances had been resolved.<sup>246</sup> The 2014 APEC summit that saw Abe and Xi shake hands could not bring Park and Abe to do the same formality for the cameras. The same lack of amity was seen in an early March 2014 trilateral U.S.-Japan-South Korea executive level meeting in which Park refused to acknowledge Abe.<sup>247</sup>

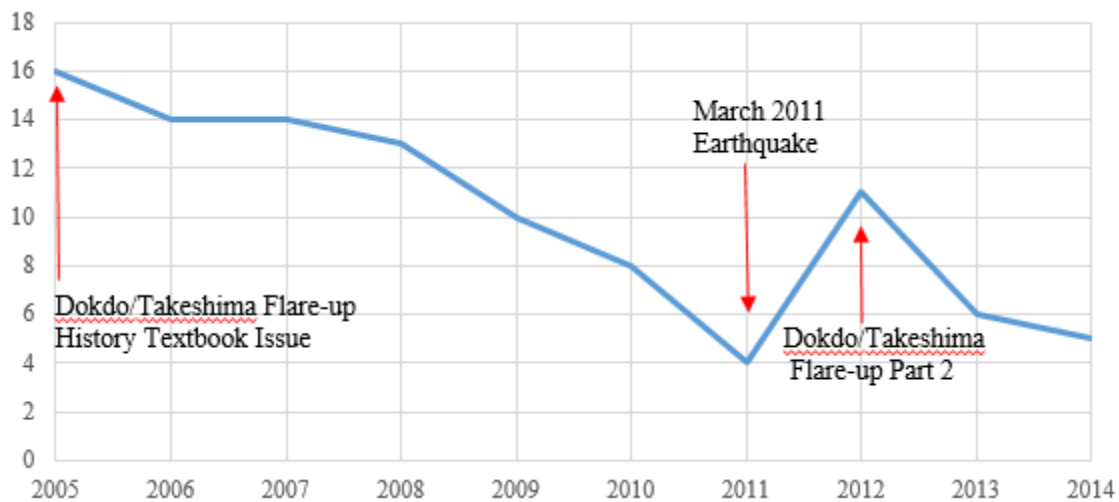
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<sup>245</sup> David C. Kang and Ji-Young Lee, “Japan-Korea: More Squabbling, Little Progress,” *Center for Strategic & International Studies*, Comparative Connections, 8, no. 2 (July 2006): 4.

<sup>246</sup> David C. Kang and Jiun Bang, “Japan-Korea Relations: More Naughty than Nice,” *Center for Strategic & International Studies*, Comparative Connections, 15, no. 3 (January 2014): 1.

<sup>247</sup> Jun Hongo, “Chilly Abe-Xi Handshake Follows Historical Pattern,” *WSJ Blogs - Japan Real Time*, JSTNov 2014, <http://blogs.wsj.com/japanrealtime/2014/11/10/photos-chilly-abe-xi-handshake-follows-historical-pattern/>.

Figure 7. Track-one Ministerial and Executive Level Meetings



Track-one ministerial and executive level meetings. Each meeting indicates a meeting on the deputy-minister level and above between South Korean and Japanese officials. Data derived from Japanese MoFA and Center for Strategic and International Studies—Comparative Connections.

The frosty relationship between Abe and Park has had a corresponding effect on track-one ministerial meetings from 2013 onward. The trilateral executive and ministerial meetings stopped and so did many of the other lower-level ministerial meetings that had occurred from 2005 to 2012. The only meetings that have occurred from 2013 to 2015 with any consecutiveness have been the China-Japan-South Korea FTA negotiations. Recently in 2015, there has been a resumption in meetings between Japan and South Korea on the ministerial level. In March, the trilateral China-Japan-South Korea foreign ministers meeting resumed.<sup>248</sup>

### c. *Evidence: Animosities Bleeding into Previous FTA Negotiations*

The example of the scuttling of Japan-South Korea FTA is one of political and historical grievances affecting South Korea's FTA. From December 2003 to November 2004 there were six rounds of negotiations toward a bilateral FTA, the final round ended inconclusively over Japanese refusal to remove tariffs or increase quotas on South

<sup>248</sup> "Japan-ROK Foreign Ministers' Meeting," *Ministry of Foreign Affairs of Japan*, March 23, 2015, [http://www.mofa.go.jp/a\\_o/na/kr/page3e\\_000350.html](http://www.mofa.go.jp/a_o/na/kr/page3e_000350.html).

Korean seaweed. While FTA negotiations stopped in 2004, other ministerial and executive track-one meetings occurred from 2005 to 2008 to restart these negotiations. Yet, in 2008, attempts at restarting the bilateral FTA were scuttled. According to a 2012 MoFA White Paper, the prime reason for the FTA to be scuttled was Japanese intransigence over seaweed imports.<sup>249</sup> Yet, the 2012 White Paper ignores the fact that Japan in January 2006 had come back to South Korea and expanded its quota of South Korean seaweed imports as demanded.<sup>250</sup> The timing of Japan's concessions on seaweed, however, occurred between the 2005 Dokdo/Takeshima flare-up and President Roo My-hun's inflammatory statement concerning Japanese maritime activity. Perhaps not coincidentally, the 2012 White Paper does make an oblique reference to the shaky political situation between Japan and South Korea in concern of restarting a bilateral FTA when it stated that both countries needed to "manage their economic and trade relations in a stable manner."<sup>251</sup>

Behind government and industry positions concerning Japan, there is an underlying negative public opinion regarding Japan. In a 2015 public opinion poll conducted by Genron NPO concerning South Korean views of Japan, 72.5% of South Korean respondents held an unfavorable view of Japan, which was an increase from the previous year poll.<sup>252</sup> The two biggest reasons for these unfavorable views in the minds of South Koreans were due to Japanese official positions on the status of Dokdo, Japan not recognizing South Korean comfort women, and "Japan's lack of remorse for historical invasion of South Korea."<sup>253</sup> When asked if South Koreans felt greater affinity toward either China or Japan, 41% responded they felt greater affinity for China and 11% felt greater affinity for Japan.<sup>254</sup> Despite these negative feelings, 46.6% of South Koreans

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<sup>249</sup> "Chapter 4: Reinforcing Economic and Trade Diplomacy," 2012 Diplomatic White Paper (Seoul, South Korea: ROK Ministry of Foreign Affairs, 2012), 152, [http://mofa.go.kr/ENG/policy/whitepaper/index.jsp?menu=m\\_20\\_160](http://mofa.go.kr/ENG/policy/whitepaper/index.jsp?menu=m_20_160).

<sup>250</sup> David C. Kang, "Japan-Korea Relations: Seirei Ketsuzetsu (Cold Politics, Warm Economics)," *Center for Strategic & International Studies*, Comparative Connections, 8, no. 1 (April 2006): 6.

<sup>251</sup> "Chapter 4: Reinforcing Economic and Trade Diplomacy," 177.

<sup>252</sup> "The 3rd Japan - South Korea Joint Public Opinion Poll (2015)," 4.

<sup>253</sup> Ibid., 6.

<sup>254</sup> Ibid., 16.

agree that “economic growth in Japan is both beneficial and necessary for South Korea,” while 37% view Japanese economic growth as a threat.<sup>255</sup>

*d. Summary of Evidence and Analysis*

Both state-to-state and business-to-business relationships failed to overcome political-historical-territorial grievances that have flared up from 2005 to the present, and that such grievances have had a tangible effect on previous attempts to reach a bilateral FTA. There has been recent progress in business-to-business relationships, and a redoubled effort by the *Keidanren* on patching up the political relationship between South Korean and Japanese leaders. Yet, FKI and KITA have not shown similar efforts on their part to publicly engage with South Korean and Japanese leaders to create political reconciliation. Overall, political-historical animosities are more of an issue on the South Korean side of the trilateral FTA negotiations and will continue to act as a drag force on future FTA cooperation. Thus, despite Japanese concessions, the South Korean side of the negotiating table had lost the will to resume the FTA at the same time South Korean domestic and political opinion had turned particularly anti-Japanese.

**C. FINAL ANALYSIS AND CONCLUSION**

Of the four potential explanations for why there has been a lack of progress toward a China-Japan-South Korea FTA assessed, the fourth explanation of historical-political animosities is the strongest. Political, historical, and territorial grievances have seeped into not only previous negotiations concerning a bygone bilateral FTA, these grievances have been strong enough to spoil Japanese and South Korean business-to-business relationship over an extended period. In particular, these grievances seem to affect the South Korean business groups more than the *Keidanren* in that only the *Keidanren* is active in trying to repair the state to state relationship that has suffered progressively since 2005.

While this chapter has identified that South Korea does not view the trilateral FTA as an economic priority, this explanation does not have the same force on the South

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<sup>255</sup> “The 3rd Japan - South Korea Joint Public Opinion Poll (2015),” 24.

Korean body-politic akin to historical and political grievance. The opinion polls from South Korea show that anti-Japanese sentiment is strong, and in some respects, it is increasing over time. These views have had a stultifying effect on South Korean politicians and South Korean professional business groups interacting with their Japanese counterparts.

As for the other two explanations of the trilateral FTA not being in the interest of agricultural groups and concerns of competition over the Chinese domestic market, these explanations provide weak causal links for explaining a lack of progress. While KPL is proficient at getting protestors in the streets and lobbying South Korean politicians, they and it are adeptly handled through key concessions by the South Korean government. As for KITA and FKI being concerned about competition with Japanese TNCs, MoTIE and MoFA have not registered the same concerns. There is a disjuncture between business interest groups in South Korea with their bureaucratic counterparts in the government that prevents this explanations for being strong enough to explain a lack of progress toward the China-Japan-South Korea FTA.



## **V. CHINA: TRILATERAL FTA NOT AN ECONOMIC PRIORITY FOR THE PRC**

### **A. INTRODUCTION**

This chapter will test four potential explanations for a lack of progress toward a China-Japan-South Korea FTA on the Chinese side of the negotiating table. These explanations focus on Chinese perceptions of economic priority, domestic interests, foreign business competition, and political-historical grievances. The chapter will argue that the strongest reason for a lack of progress by the Chinese is that the PRC does not view the trilateral FTA as an economic priority. After outlining the four potential explanations, the following sections will examine the evidence in order to test the strength of each explanation.

### **B. EVIDENCE AND ANALYSIS**

This section will present the empirical evidence for the four potential explanations that motivate the Chinese in regard to the trilateral FTA. Due to the opaque nature of PRC policy making, a majority of the evidence comes from open source media rather than official white papers.

#### **1. Explanation 1: PRC Economic Priority**

The first potential explanation to be tested is if the PRC does not view the trilateral FTA as an economic priority, then the China-Japan-South Korea FTA is less likely. For evidence, the opinion of academics from the Chinese Academy of Social Sciences (CASS) as well those opinions of the Ministry of Commerce (MOFCOM) and PRC leadership will be examined. This explanation will show that China's academic community and MOFCOM perceptions do not view pursuing the trilateral FTA as an economic priority as compared to RCEP, and that this explanation is causally the strongest in regard to the lack of progress toward the trilateral side of the Chinese side of the negotiating table.

*a. Evidence: MOFCOM and PRC Trade Policy*

As noted by a 2015 U.S. Congressional report on China's FTA strategy, "China does not publish an official FTA policy."<sup>256</sup> The PRC does not provide white papers similar to that of Japan and South Korea, which provide insight into what these governments expect to receive from FTAs. Rather, one is left with piecing together a series of statements from open source publications as to what official Chinese thinking is in regard to PRC FTA policy. Thus, this section will draw on such statements from MOFCOM and CCP officials in order to show that PRC FTA policy does not prioritize the China-Japan-South Korea FTA similar to that of RCEP.

(1) MOFCOM and CCP Support for Trilateral FTA

As China-Japan-South Korea concluded their 2011 joint study for a trilateral FTA, MOFCOM voiced its support and optimism for a deal that would bring economic benefits as well as a counterweight to TPP. In an official 2012 China Daily article, the trilateral FTA was touted as providing China a 1.1%–2.9% boost in GDP—far above the expectations of the trilateral study group as detailed in Chapter II.<sup>257</sup> In addition, a 2012 MOFCOM press statement hailed the trilateral FTA as the counter to the TPP.<sup>258</sup> MOFCOM stressed the importance of a successful conclusion of the deal or otherwise China would "lose the advantages it gains from the economic integration of Asia."<sup>259</sup> MOFCOM also touted the deal as a tool for accelerating growth in the region after the Global Financial Crisis (GFC).<sup>260</sup>

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<sup>256</sup> Nargiza Salidjanova, "China's Trade Ambitions: Strategy and Objectives behind China's Pursuit of Free Trade Agreements," Staff Research Project (Washington, D.C.: U.S. - China Economic and Security Review Commission, May 28, 2015), 13, <http://origin.www.uscc.gov/sites/default/files/Research/China%27s%20Trade%20Ambitions%20-%2005.28%2015.pdf>.

<sup>257</sup> Xu Changwen, "The Benefits of An FTA for Asia," *China Daily Online*, 13 Dec 12, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/CPP20121213968014#index=19&searchKey=18620604&rpp=25](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CPP20121213968014#index=19&searchKey=18620604&rpp=25).

<sup>258</sup> "Calls to Advance Trade Ties," *MOFCOM*, August 24, 2012, [http://fta.mofcom.gov.cn/enarticle/chinarihen/chinarihennews/201208/10756\\_1.html](http://fta.mofcom.gov.cn/enarticle/chinarihen/chinarihennews/201208/10756_1.html).

<sup>259</sup> Ibid.

<sup>260</sup> Ding Qingfen, "Asian Countries 'Should Boost Ties,'" *China Daily*, 09 Apr 13, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/CPP20130409968074#index=17&searchKey=18620604&rpp=25](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CPP20130409968074#index=17&searchKey=18620604&rpp=25).

## (2) MOFCOM Shift Priority From Trilateral FTA to RCEP

Yet, MOFCOM signaled a shift in thinking in 2013 toward RCEP as well as a rapprochement with the idea of a successful TPP. In a 2013 China Daily article, MOFCOM deputy trade negotiator stated that “The Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership have common ultimate goals and will be the stepping stone for integrating Asia-Pacific’s FTAs.”<sup>261</sup> In addition, the deputy director-general of MOFCOM’s international department stated that “China holds an open attitude to the TPP.”<sup>262</sup> Nonetheless, MOFCOM would still “prioritize its trade talks with South Korea and Japan, while steadily advancing the RCEP.”<sup>263</sup> Thus, MOFCOM put forward a parallel track to negotiating both the trilateral FTA and RCEP contemporaneously.

A recent shift in priority to RCEP and away from the China-Japan-South Korea FTA by MOFCOM is seen in recent policy statements. In a 2014 statement concerning RCEP, MOFCOM made no mention of the trilateral FTA, but rather, MOFCOM posed RCEP and TPP together as mutually complimentary and as pillars of a future FTAAP.<sup>264</sup> The importance and significance of the China-Japan-South Korea FTA had been downgraded in comparison to RCEP and FTAAP in that the trilateral FTA is no longer termed as a mega-FTA, but as another regional bilateral FTA with a plus one.<sup>265</sup> Premier Li Keqiang’s Government Work Report delivered to the Third Session of the Twelfth National People’s Congress downplayed the trilateral FTA by lumping it together in the

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<sup>261</sup> Li Jiabao, “Senior Trade Official Urges Integration of FTAs in East Asia,” *China Daily Online*, 21 Jun 13, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/CPP20130621968042#index=14&searchKey=18620604&rpp=25](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CPP20130621968042#index=14&searchKey=18620604&rpp=25).

<sup>262</sup> Ibid.

<sup>263</sup> Ibid.

<sup>264</sup> “Give Play of China’s Important Role and Accelerate RCEP Negotiations,” *MOFCOM*, September 1, 2014, [http://fta.mofcom.gov.cn/article/enasean/chianaseannews/201411/18815\\_1.html](http://fta.mofcom.gov.cn/article/enasean/chianaseannews/201411/18815_1.html).

<sup>265</sup> Zhong Nan, “China Will Speed Up Free Trade Talks This Year,” *China Daily USA*, January 15, 2015, [http://usa.chinadaily.com.cn/business/2015-01/15/content\\_19326150.htm](http://usa.chinadaily.com.cn/business/2015-01/15/content_19326150.htm).

same sentence for promoting FTA talks with the Gulf Cooperation Council and Israel, whereas RCEP was put together with FTAAP.<sup>266</sup>

Overall, MOFCOM and PRC officials have changed priority from the trilateral FTA to RCEP. This is not to say that MOFCOM and the PRC no longer view the China-Japan-South Korea FTA as providing economic benefits, but that their focus has shifted to RCEP while still allowing the trilateral FTA to be pursued in tandem with other FTA negotiations.

**b. Evidence: Chinese Academic Policy Position**

**(1) CASS and Other Scholarly Support for Trilateral FTA**

In a joint 2012 interview with both the director of the CASS Institute of World Economics and Politics and the Renmin University School of Economics deputy dean, both expressed positive views toward the trilateral FTA.<sup>267</sup> Song Hong, the director of the CASS Institute of World Economics, highlighted the much needed development of a formal economic institutional framework in NEA while Wang Jinbin, the Renmin University deputy dean, highlighted the benefits of a regional agreement that could lead to “healthy development” post GFC.<sup>268</sup> Both agreed that the trilateral FTA would serve as a counterweight to TPP in leading toward a much wider Asia-Pacific FTA.<sup>269</sup>

The positive opinions of the trilateral FTA were repeated in a 2013 article by Jing Linbo and Yuan Pinghong, researchers at the CASS Institute of Financial and Economic Strategic Studies, published by the *Guoji Maoyi*, a monthly journal sponsored by the

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<sup>266</sup> Li Keqiang, “Full Text of Government Work Report Delivered by Li Keqiang at 3rd Session of 12th NPC 5 March 2015” (Speech, 3rd Session of the 12th NPC, Beijing, China, 05 Mar 15), [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/CHO2015030500513318#index=10&searchKey=18620707&rpp=25](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CHO2015030500513318#index=10&searchKey=18620707&rpp=25).

<sup>267</sup> “JJCKB Interviews PRC Experts on Launch of PRC-Japan-ROK FTA Negotiations,” *Jingji Cankao Bao*, 21 Nov 12, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/CPP20121121308003#index=83&searchKey=18660722&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CPP20121121308003#index=83&searchKey=18660722&rpp=10).

<sup>268</sup> Ibid.

<sup>269</sup> Ibid.

MOFCOM Research Institute of International Trade.<sup>270</sup> Yet, the CASS article emphasized more than just economic concerns when pursuing FTAs. The article called on Chinese FTA policy to “consider changes in the global political and diplomatic setup and China’s strategic place in the global political structure and economic order.”<sup>271</sup> Specifically, CASS advocated the position that Chinese FTAs, such as the trilateral FTA, should be used to “to seize the initiative and gain a voice in the writing of the new rules of global trade.”<sup>272</sup>

Additionally, a 2013 article in the weekly Beijing *Liaowang* involving CASS director Zhang Yunling argued that the proposed WTO-Plus FTAs, such as TPP, are designed to rewrite the post-war rules and marginalize China in the current economic order.<sup>273</sup> Agreements such as TPP, which include provisions well beyond trade in goods and services, would end up “re-regulating the conduct of the economic players involved” in order to balance the playing field against developing and competitive countries such as China.<sup>274</sup> Essentially, “the developed countries are hanging together, opening up to one another and jointly writing new standards, before asking other countries to fall in line.”<sup>275</sup>

## (2) CASS Change of Tone and Opinion Toward Trilateral FTA

Yet, a pessimistic tone toward the China-Japan-South Korea FTA is taken by the same 2013 *Liaowang* article in that China does not control the pace of the negotiations of the trilateral FTA, and that the agreement serves Japanese purposes as a bargaining tool in its TPP negotiations with America rather than as a benefit for China.<sup>276</sup> According to Liu Junhong of the Chinese Institute of Contemporary International Relations, “the China-Japan-South Korea EPA negotiations and the Regional Comprehensive Economic

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<sup>270</sup> “CASS Study on China’s FTA Strategy,” *Beijing Guoji Maoyi*, 26 Aug 13, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/CHR2013082665784680#index=61&searchKey=18620707&rpp=25](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CHR2013082665784680#index=61&searchKey=18620707&rpp=25).

<sup>271</sup> Ibid.

<sup>272</sup> Ibid.

<sup>273</sup> Shang Qianming et al., “The Politics and Economics Behind Free Trade Negotiations,” *Beijing Liaowang*, 06 May 13, 19–22.

<sup>274</sup> Ibid.

<sup>275</sup> Ibid.

<sup>276</sup> Ibid.

Partnership [RCEP] negotiations have been Japan's main tools in its jockeying for power with the United States and Europe."<sup>277</sup> Both academics in the article agree that the set of FTAs being negotiated as of 2013 did not serve China's best economic and political interests, to include the China-Japan-South Korea FTA.<sup>278</sup>

As the trilateral FTA entered into its second set of negotiations, opinions from various CASS researchers supported shifting China's trade priority from the China-Japan-South Korea FTA to RCEP. According to Zhang Yunling, "All in all, the road for establishing the trilateral FTA will not be smooth in view of the remarkable differences in the economic structures," and that "China should prioritize the establishment of the Regional Comprehensive Economic Partnership, which can compete with the United States-led Trans-Pacific Partnership agreement."<sup>279</sup> A 2014 article by Mei Xinyu, a researcher at the Chinese Academy of International Trade and Economic Cooperation, dismissed any negative implications if the deal fell through, implying that the trilateral FTA was not that consequential for China.<sup>280</sup>

For those academics who supported shifting priority from the trilateral FTA to RCEP, they also stressed the importance and potential benefits of TPP. In a 2014 Beijing *Jingji Cankao Bao* article, Zhang Yunling softened his position that TPP could divide the trade order between developed and developing states.<sup>281</sup> Rather, the rules proposed by TPP had long-term positive effects especially for countries such as China, and that developing countries could "concentrate on adjusting their economic structure and development policies to adapt . . . and rebuild their comparative advantage in a bid to develop new competitiveness and find a new engine for economic development."<sup>282</sup> In

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<sup>277</sup> Qianming et al., "The Politics and Economics Behind Free Trade Negotiations."

<sup>278</sup> Ibid.

<sup>279</sup> Li Jiabao, "Trilateral FTA Talks Still at Exploratory Stage - Business - China Daily Asia," *China Daily Asia*, July 31, 2013, [http://www.chinadailyasia.com/business/2013-07/31/content\\_15080825.html](http://www.chinadailyasia.com/business/2013-07/31/content_15080825.html).

<sup>280</sup> Mei Xinyu, "A Costly China-Japan Stalemate," *Beijing Review Online*, 9 Sept 14, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/CHR2014090928528369#index=39&searchKey=18620707&rpp=25](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CHR2014090928528369#index=39&searchKey=18620707&rpp=25).

<sup>281</sup> Fang Ye, "Zhang Yunling Urges China To Use New External Developments," *Jingji Cankao Bao*, July 3, 2014, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/CHR2014070344854129#index=15&searchKey=18620153&rpp=10](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CHR2014070344854129#index=15&searchKey=18620153&rpp=10).

<sup>282</sup> Ibid.

addition, the WTO-plus provision in TPP provide for "the need to lower and eliminate the institutional and policy obstacles at home" so as to increase economic development.<sup>283</sup>

*c. Summary of Evidence and Analysis*

Both MOFCOM and opinions from CASS perceive that RCEP should take priority rather than the trilateral FTA. Greater economic priority for RCEP is seen as competition or hedging against TPP, not necessarily because of greater gains in economic welfare or efficiency. The softening of opinions toward TPP does not diminish the view that RCEP should be a priority for the PRC.

**2. Explanation 2: PRC SOE Interest**

The second explanation for a lack of progress toward a China-Japan-South Korea FTA is that China perceives domestic business interests being hurt by the trilateral FTA. According to the 2011 trilateral study, the Chinese machinery, automobile, and chemical sectors would be negatively affected by the China-Japan-South Korea FTA, which are dominated by influential Chinese SOEs. This section will show that China has an established pattern of protecting key SOE sectors in FTAs negotiated with other countries. The ability of the China-Japan-South Korea to negatively affect Chinese SOEs depends entirely on whether or not a WTO-plus agreement is being negotiated, which makes domestic interests a weak causal argument for a lack of progress. In order to show that Chinese SOEs are influential actors in the Chinese economy, this section will frame how the PRC views the utility of such enterprises as well as how the PRC has protected SOE-dominated industries in Chinese FTAs.

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<sup>283</sup> Ye, "Zhang Yunling Urges China To Use New External Developments."

**a. Evidence: PRC Market Reforms Reducing Influence of SOEs**

**(1) Reducing the Presence of SOEs in the Chinese Economy**

Since 1978, the PRC has consistently pushed reform of SOEs that has caused these enterprises to play a reduced role in the overall Chinese economy. The PRC achieved the transition from a SOE dominated planned economy to a market economy by introducing a dual track system in the 1980s and early 1990s that allowed for the coexistence of both the planned and market system by setting prices that were preferential to SOEs and allowing private businesses to sell at market prices. This allowed for excess industrial inputs to be freed up and used efficiently through the market economy. The size of SOEs were kept constant while private and semi-private enterprises were allowed to expand so as to eclipse the relative contribution to GDP by SOEs. Barry Naughton terms this as “growing out of the plan” in which the planned economy was kept constant in its absolute size so that as the market economy took off, the relative size of the planned economy decreased.<sup>284</sup> In the mid-1990s, the dual track system was replaced with a market system.

Reforms brought on by China’s accession to the WTO and compliance with WTO rules has further reduced the presence of SOEs in the Chinese economy. From 2003 to 2013, the number of SOEs in which the PRC owned majority shares was reduced from 196 to 115.<sup>285</sup> According official PRC statistics, the national presence of SOEs as a percentage of total assets, employment, gross industrial output, and enterprises operating in the PRC has been reduced markedly since 1998 (Figure 8). Yet, SOEs still control significant market share in sectors that the PRC deems as strategic and pillar industries. As of 2014, SOEs control nearly 40% Chinese corporate assets.<sup>286</sup> Of those assets

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<sup>284</sup> Barry J. Naughton, *The Chinese Economy: Transitions and Growth* (Cambridge, Mass: The MIT Press, 2006), 92.

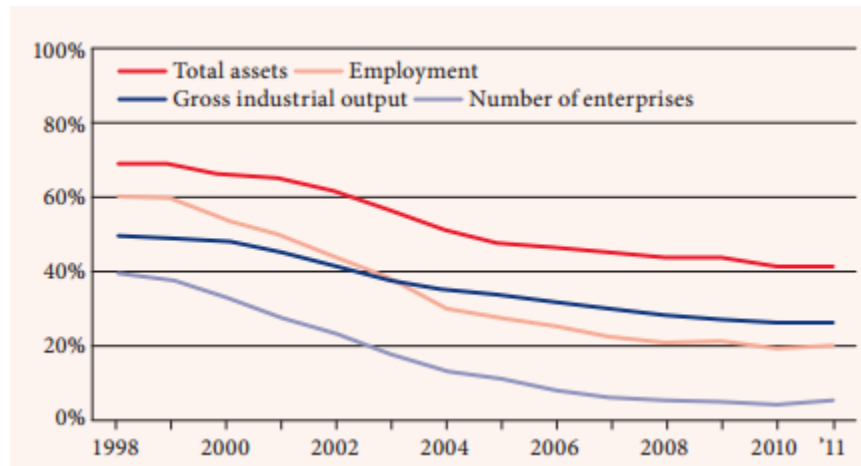
<sup>285</sup> Gang Fan and Christopher C. Hope, “The Role of State-Owned Enterprises in the Chinese Economy,” in *U.S. - China Economic Relations in the Next Ten Years: Toward Deeper Engagement and Mutual Benefit* (Hong Kong SAR: China-United States Exchange Foundation, 2013), 356, [http://www.chinausfocus.com/wp-content/uploads/2013/05/2022-Part-1\\_eng.pdf](http://www.chinausfocus.com/wp-content/uploads/2013/05/2022-Part-1_eng.pdf).

<sup>286</sup> Salidjanova, “China’s Trade Ambitions,” 28.



controlled by SOEs, 82% were from the “petrochemicals, electric power and grid, defense, telecommunications, transport, mining, metallurgy, and machinery sectors.”<sup>287</sup>

Figure 8. The Share of SOEs in All Industrial Enterprises



From Gang Fan and Christopher C. Hope, “The Role of State-Owned Enterprises in the Chinese Economy,” in *U.S.–China Economic Relations in the Next Ten Years: Toward Deeper Engagement and Mutual Benefit* (Hong Kong SAR: China-United States Exchange Foundation, 2013), 361, [http://www.chinausfocus.com/wp-content/uploads/2013/05/2022-Part-1\\_eng.pdf](http://www.chinausfocus.com/wp-content/uploads/2013/05/2022-Part-1_eng.pdf).

## (2) Merging of CCP and SOE Interests

In addition to still being a significant part of the Chinese economy, SOEs have been subject to increasing control and protection by the CCP. In 2006, the State-owned Assets Supervision and Administration Commission (SASAC) put forward a proposal that SOEs in certain economic sectors of Chinese economy should have a majority market share in those sectors depending on whether or not those sectors were deemed as strategic or pillar industries, which include those sectors negatively affected by the trilateral FTA.<sup>288</sup> Strategic industries are sectors in which the PRC “must play a leading role in every enterprise,” whereas pillar industries “must remain under state control” by SOEs.<sup>289</sup> According to a 2014 U.S. Trade Representative Report (USTR) to Congress,

<sup>287</sup> “2014 Report to Congress on China’s WTO Compliance” (Washington, D.C.: United States Trade Representative, December 2014), 79, <https://ustr.gov/sites/default/files/2014-Report-to-Congress-Final.pdf>.

<sup>288</sup> Ibid.

<sup>289</sup> “2014 Report to Congress on China’s WTO Compliance,” 79.

SASAC has tightened its grip on SOEs through the application of state security laws to SOEs and limiting Chinese SOEs from accepting FDI.<sup>290</sup> Additionally, in 2010, the Central Committee of the CCP passed a measure that requires SOEs “to establish a collective decision-making system in which the Communist Party plays a significant role in major business decision, major personnel changes, and major project arrangements,” which the CCP refers to as the Three-Major One-Large Decision Making System.<sup>291</sup>

### (3) SOE Influence in Chinese FTAs

The PRC position that machinery, automobiles, and chemicals are pillar industries is reflected in how it treats those sectors in its various FTAs that have been concluded over the last decade. For instance, the China-Switzerland FTA has a claimed 90% and greater tariff exemption rate, but for products that fall under machinery and chemical classification, the duty exemption rate falls between 64%–78% of Swiss goods imported by China.<sup>292</sup> Another instance of built-in protectionism of pillar industries is seen in the China–Taiwan Economic Cooperation Framework Agreement (ECFA). Despite the inclusion of Taiwanese chemical products under the Early Harvest Program (EHP) of the China–Taiwan ECFA, the total number of chemical products included only accounted for 10% of what the Taiwanese originally asked for in negotiations.<sup>293</sup>

While Chinese FTAs can be credited for having greater than 90% tariff exemption rates, these FTA are far from being termed as WTO-plus agreements. A majority of Chinese FTAs share protections for strategic and pillar industries similar to that of the Chinese FTAs with Switzerland and Taiwan.<sup>294</sup> The consistency by which the PRC protects key industries such as chemicals, automobiles, and machinery supports the explanation of domestic interests causing a lack of progress toward a trilateral FTA. Yet, the explanation assumes that China would agree to a WTO-plus version of the China-Japan-South Korea FTA. If a trilateral FTA were brought to Chinese standards of

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<sup>290</sup> Ibid., 80.

<sup>291</sup> Ibid.

<sup>292</sup> Salidjanova, “China’s Trade Ambitions,” 17.

<sup>293</sup> Ibid.

<sup>294</sup> Ibid., 16.

selective tariff elimination similar to previous Chinese FTAs, then SOE interests could be mollified.

***b. Summary of Evidence and Analysis***

Overall, Chinese SOE interests are only hurt if the China-Japan-South Korea FTA is a WTO-plus agreement that precludes the usual Chinese pattern of picking and choosing tariff eliminations for key industries. If all three countries agree in principle to create a WTO-plus agreement in which Chinese SOEs would be hurt, these firms and their allies in the CCP would push back against a trilateral FTA. If the China-Japan-South Korea FTA is less than a WTO-plus FTA, then the ability of the PRC to ensure protection for key industries increases, which decreases the likelihood of Chinese SOE intransigence. Thus, the explanation of domestic interests slowing the progress of the trilateral FTA on the Chinese side of the negotiating table is a weak causal argument.

**3. Explanation 3: PRC Concerns of Relative Gains in Domestic Market**

The third potential explanation to be tested is that if the PRC views Chinese SOEs as operating at a disadvantage to Japanese and South Korean competitors in the domestic market, then a trilateral FTA is less likely. This section will show that despite admitting the weakness of PRC SOEs, the recent China-South Korea FTA has shown a willingness on the part of the PRC to open certain SOE dominated sectors. Using the China-South Korea as a template for the trilateral FTA, Chinese concerns of their SOEs does not act as a drag force on a potential trilateral FTA. This explanation will outline current problems with PRC SOEs and show that despite these problems the PRC has been willing to compromise on tariff reduction in certain SOE sectors.

***a. Evidence: PRC SOEs and PRC Willingness for SOE Reform***

The CCP has serious concerns over the performance of its SOEs and its bureaucracy, the State-owned Assets Supervision and Administration Commission (SASAC), to enforce fiscal probity among the SOE elite. PRC President Xi Jinping has launched an anti-graft campaign aimed at not only CCP members, but also focused on

China's SOEs.<sup>295</sup> Of concern for the CCP is the poor performance of its SOEs as compared to private Chinese corporations.<sup>296</sup> Xi Jinping, in state media, has called for microeconomic level reforms targeted at SOEs in order to root at graft.<sup>297</sup>

Aside from graft, Chinese SOEs have failed to provide a return on investment similar to private Chinese corporations. Despite attempts at structurally reforming some SOEs, many Chinese SOEs have consistently underperformed their private peers, and the return on investment gap between the two since 2007 has continually widened.<sup>298</sup> Chinese business commentators have openly talked about the failure of SOEs to provide adequate returns on profit due to inflexible government policies and quotas.<sup>299</sup> The Chinese government "continue[s] to call for maintaining absolute control of important sectors and strategic areas" that seems to preclude opening Chinese SOEs up to direct competition without state-support.<sup>300</sup>

Yet, the recently signed China-South Korea FTA shows PRC willingness to open up some SOE dominated sectors to direct competition. While the Chinese automobile sector is protected in the China-South Korea FTA, the SOE dominated petroleum sector has been opened, albeit on the higher end of the elimination schedule of 15 years after ratification.<sup>301</sup> This indicates that the PRC is willing to open some of its sectors up to direct competition. Although, the long lead time up to tariff elimination also suggests that the PRC does not want the change to happen immediately.

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<sup>295</sup> "Xi's New Year's Resolution: Reform China's State-Owned Enterprises," *The Diplomat*, accessed April 17, 2015, <http://thediplomat.com/2015/01/xis-new-years-resolution-reform-chinas-state-owned-enterprises/>.

<sup>296</sup> "Fixing China Inc.," *The Economist*, August 30, 2014, <http://www.economist.com/news/china/21614240-reform-state-companies-back-agenda-fixing-china-inc>.

<sup>297</sup> "Xi Stresses CPC's Leadership, Supervision over SOEs - Xinhua | English.news.cn," accessed April 17, 2015, [http://news.xinhuanet.com/english/china/2015-01/13/c\\_133916868.htm](http://news.xinhuanet.com/english/china/2015-01/13/c_133916868.htm).

<sup>298</sup> "Fixing China Inc."

<sup>299</sup> Sun Qizi, "Chinese Enterprises Struggle Overseas," *Jingji Guancha Wang*, 20 May 13, [https://www.opensource.gov/portal/server.pt/gateway/PTARGS\\_0\\_0\\_200\\_203\\_121123\\_43/content/Display/CPP20130529790021#index=2&searchKey=18620465&rpp=25](https://www.opensource.gov/portal/server.pt/gateway/PTARGS_0_0_200_203_121123_43/content/Display/CPP20130529790021#index=2&searchKey=18620465&rpp=25).

<sup>300</sup> Ryan Rutkowski, "State-Owned Enterprise Reform: The Long Wait for a Chinese Temasek Continues...", *Peterson Institute for International Economics*, accessed April 23, 2015, <http://blogs.piie.com/china/?p=3726>.

<sup>301</sup> Ministry of Trade, Industry, and Energy, "China- Korea FTA."

***b. Summary of Evidence and Analysis***

Overall, CCP concerns over the effectiveness of PRC SOEs does not act as a drag force on the China-Japan-South Korea FTA. Despite corruption crackdowns—which could also be explained by political motivations and consolidation of power—and the inability of SOEs to provide adequate return on investment, the PRC is willing to open certain sectors of state control to direct competition, albeit over an extended period of time. The China-South Korea FTA shows that China is willing to make certain concessions in regard to its SOE dominated sectors such as petroleum.

**4. Explanation 4: PRC Concern for Political-Historical Animosity**

The fourth potential explanation to be tested is that if historical and political grievances negatively affect the economic relationship between China and Japan, then a trilateral FTA is less likely. This section will show that despite political and historical animosities, Sino-Japanese relations are able to remain at an even keel of hot economics—cold politics and do not act as a drag force on the trilateral FTA. Evidence for this position is taken from instances of high Sino-Japanese tension in 2005, 2010, and 2012. Specifically, the ability of state-to-state relationship on the track-one level of economic engagements being mended due to the mediating influence of business-to-state relationship will be examined during these time periods.

State-to-state ties will be assessed through official statements and papers through open-source media and official government media outlets. Business-to-state links will be assessed through incidences of the business community intervening during the three dispute time periods. Specifically, action by the *Keidanren* and other business groups meeting with state officials will be tracked.

***a. Evidence: Testing the Relationship in 2005***

**(1) 2005 State-to-State Relationship**

Starting in early April 2005, following anti-Japanese riots due to historical grievances and lasting for nearly a year, China-Japan state to state relationship suffered

but still existed on lower levels and on different subjects than those that were driving the acrimony. By April 21, both foreign ministries had deescalated their tones and called for bilateral meetings.<sup>302</sup> On April 22, Bo Xilai, the Chinese commerce minister, continued the positive signaling by stressing the importance of China-Japan economic interdependence and dismissed public calls for a boycott of Japanese goods as counterproductive.<sup>303</sup> Asia–Africa Summit in Jakarta on April 23, President Hu Jintao and PM Junichiro Koizumi met, shook hands, and held a private meeting that was deemed a successful rapprochement by Koizumi.<sup>304</sup>

Beyond national leader and foreign minister meetings, more prosaic state-to-state links continued. The second China-Japan climate change dialogue occurred the same month as the Hu and Koizumi meeting, and was followed three months later by an annual security related officials meeting.<sup>305</sup> Even when Koizumi visited Yasukuni Shrine in October, China-Japan was able to hold monthly and multi-issued consultative meetings from September 2005 to May 2006 when ministerial talks resumed.<sup>306</sup> Only during the months of May and June 2005 did China-Japan not hold any meetings or talks between the various parts of their governments.

## (2) 2005 Business-to-State Relationship

During the see-sawing tensions of 2005, the *Keidanren* remained very active and served as an intermediary. On May 23, the *Keidanren* held a luncheon with the Chinese Vice Premier Wu Yi,<sup>307</sup> and the New Japan-China Friendship Committee for the 21st Century met in Kunming City led by Fuji-Xerox in July.<sup>308</sup> On separate occasions, the

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<sup>302</sup> Norimitsu Onishi, “Japan Softens Tone and Seeks Talks with China: [3 Edition],” *International Herald Tribune*, April 21, 2005, sec. NEWS.

<sup>303</sup> “China’s Trade Policy Toward Japan Remains Unchanged: Chinese Commerce Minister,” *Xinhua News Agency*, April 22, 2005.

<sup>304</sup> James J. Przystup, “Japan - China: No End to History,” *Center for Strategic & International Studies*, Comparative Connections, 7, no. 2 (July 2005): 4.

<sup>305</sup> Ministry of Foreign Affairs of Japan, “Japan-China Relations,” accessed December 1, 2014, <http://www.mofa.go.jp/region/asia-paci/china/>.

<sup>306</sup> Ibid.

<sup>307</sup> Przystup, “Japan - China: No End to History,” 5.

<sup>308</sup> MoFA of Japan, “Japan-China Relations.”

*Keidanren* visited Wen Jiabao on September 26,<sup>309</sup> and then with Hu Jintao on September 30 in the lead up to Koizumi's visit to Yasukuni Shrine the following month.<sup>310</sup> On October 19, *Keidanren* officials commented that political tensions had no effect on China-Japan economic relations.<sup>311</sup>

### (3) 2005 Summary of Results

Both relationships continued to perform sufficiently despite the rise in political-historical animosities. State-to-state links took nearly a year to completely coalesce on the track one ministerial level, but other diplomatic dialogues were able to continue. Business-to-state links served in an intermediary role when ministerial track one level diplomacy failed and maintained dialogue with China's top leadership.

#### ***b. Evidence: Testing the Relationship in 2010***

##### (1) 2010 State-to-State Relationships

Despite rising tensions in the East China Sea that marked the beginning of 2010, China and Japan was still able to conduct track-one level diplomacy. On May 5, the fourth trilateral foreign ministerial summit between China-Japan-South Korea was held in Gyeongju, South Korea as well as other separate meetings concerning trilateral free trade and investment agreements.<sup>312</sup> This was followed shortly thereafter by another trilateral summit between leaders of China-Japan-South Korea on May 30 in Jeju, South Korea.<sup>313</sup> This meeting produced another forum for trilateral cooperation, the Trilateral Cooperation Secretariat, and a renewed commitment to trilateral free trade and

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<sup>309</sup> James J. Przystup, "Summer Calm," *Comparative Connections* 7, no. 3 (October 2005): 7.

<sup>310</sup> "Keidanren Made Covert Trip to China Last Month," *The Japan Times Online*, October 23, 2005, <http://www.japantimes.co.jp/news/2005/10/23/national/keidanren-made-covert-trip-to-china-last-month/>.

<sup>311</sup> James J. Przystup, "Yasukuni Stops Everything," *Comparative Connections* 7, no. 4 (January 2006): 10.

<sup>312</sup> MoFA of Japan, "Japan-China Relations."

<sup>313</sup> *Ibid.*

investment agreements.<sup>314</sup> The sixth annual Tokyo-Beijing Forum between various Chinese and Japanese ministries brought more calls for cooperation.

By the time September 7, 2010 and the fishing boat incident occurred, China-Japan formal bilateral relations had reached a new high-water mark. No more than two months would have to transpire before an informal meeting between PM Kan and Premier Wen occurred at the Asia-Europe Meeting with promises for more bilateral talks.<sup>315</sup> In October, there were anti-Japanese protests in China, but they were not as intense or as violent as those in 2005. In October, Chinese and Japanese foreign ministers were able to meet and talk about issues other than just the East China Sea.<sup>316</sup> The November APEC summit in Yokohama brought PM Kan and President Hu together.<sup>317</sup> The first half of 2011 saw relations return to their normal tempo of diplomacy with annual trilateral ministerial meetings occurring on schedule.<sup>318</sup>

## (2) 2010 Business-to-State Relationship

During the 2010 incident, a major rift between the business-to-state linkages surfaced. Japan's business community accused China of cutting rare-earth mineral production and shipment in September shortly after the fishing trawler incident as a form of punishment.<sup>319</sup> Multiple Japanese ministries and the *Keidanren* attempted to convince the Chinese to return rare-earth trade levels to previous rates but were rebuffed by claims that the reduction was necessary in order to prevent such materials from being depleted.<sup>320</sup> Analysis of events afterwards show that considerations of a Chinese draw-

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<sup>314</sup> See TCS, "Trilateral Cooperation Secretariat (TCS)," accessed December 18, 2014, <http://tcs-asia.org/dnb/main/index.php>.

<sup>315</sup> James J. Przystup, "Troubled Waters: Part II," *Comparative Connections* 12, no. 4 (January 2011): 6.

<sup>316</sup> Ministry of Foreign Affairs of Japan, "MOFA: Overview of Japan-China Foreign Ministers' Meeting," accessed December 18, 2014, <http://www.mofa.go.jp/region/asia-paci/china/fmm101029.html>.

<sup>317</sup> Przystup, "Troubled Waters: Part II," 13.

<sup>318</sup> See MoFA of Japan, "Japan-China Relations."

<sup>319</sup> Keith Bradsher and Hiroko Tabuchi, "China Is Said to Halt Trade in Rare-Earth Minerals With Japan," *The New York Times*, September 24, 2010, sec. Business / Global Business, <http://www.nytimes.com/2010/09/25/business/global/25minerals.html>.

<sup>320</sup> James J. Przystup, "Troubled Waters," *Comparative Connections* 12, no. 3 (October 2010): 10.



down in rare-earth minerals was already being considered as early as July, two months prior to the trawler incident.<sup>321</sup> Furthermore, when China did reduce global exports, Japanese exports were not singled out.<sup>322</sup>

Although the diplomatic dispute lasted for three months, 2010 also brought to light a more subtle difference in business to state linkage. 2010 marked the first time that the *Keidanren* did not meet with either the Chinese President or Premier.<sup>323</sup> Why the change in treatment occurred starting in 2010 is not stated anywhere in open-source media.

### (3) 2010 Summary of Evidence

Once again, both relationships performed sufficiently despite the rise in historical-political tensions. State-to-state relationship had actually matured since 2005 so that more lower-level ministerial meetings were able to take place. Business-to-state relationship remained effective, however, the inability of *Keidanren* leaders to meet with the Chinese Premier and President is notable.

### *c. Evidence: Testing the Relationship in 2012*

#### (1) 2012 State-to-State Relationship

Diplomatically speaking, the beginning of 2012 proceeded productively despite the ongoing tensions in the East China Sea. In May, Premier Wen and PM Noda still met for the trilateral China-Japan-South Korea summit and agreed upon continuing a trilateral free trade agreement.<sup>324</sup> Additionally, a trilateral investment agreement was signed and

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<sup>321</sup> Amy King and Shiro Armstrong, "Did China Really Ban Rare Earth Metals Exports to Japan?," *East Asia Forum*, accessed December 18, 2014, <http://www.eastasiaforum.org/2013/08/18/did-china-really-ban-rare-earth-metals-exports-to-japan/>.

<sup>322</sup> Ibid.

<sup>323</sup> Ankit Panda, "Largest-Ever Japanese Business Delegation Heads to China," *The Diplomat*, accessed December 18, 2014, <http://thediplomat.com/2014/09/largest-ever-japanese-business-delegation-heads-to-china/>.

<sup>324</sup> Ministry of Foreign Affairs of Japan, "Japan-China-ROK Trilateral Summit," accessed December 18, 2014, <http://www.mofa.go.jp/region/asia-paci/jck/summit.html>.

each country agreed to work together in concern of growing North Korean tensions.<sup>325</sup> Yet, May 2012 would be the last time for another two years until executive and high level ministerial meetings would begin.

The purchase of the Senkaku Islands by the Japanese government in September 2012 sparked a firestorm in China that placed diplomatic relations into a two-year long deep freeze. The purchase was shortly followed by riots in over a hundred Chinese cities in which Japanese businesses were targeted on a scale much larger than 2005.<sup>326</sup> Even during the annual Asia-Europe Meeting, PM Noda and Premier Wen were unable to have a chance meeting in the hotel that both were staying at in Laos.<sup>327</sup>

Yet, economics still exerted a centripetal force on the bilateral relationship. Japanese and Chinese trade ministers were still able to go ahead with negotiations over the trilateral FTA with their first meeting in March 2013. In 2013, a trilateral deputy foreign ministers meeting was held in Seoul. Five months later, a postponed annual trilateral environmental ministers meeting was held in South Korea.<sup>328</sup>

An actual breakthrough in the deadlock did not occur until a meeting in Qingdao, China on September 23, 2014, leading up to the APEC meeting in November.<sup>329</sup> The meeting allowed Abe and Xi to meet at APEC and to be photographed shaking hands, and in November, China-Japan foreign ministerial meeting occurred for the first time in two years.<sup>330</sup>

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<sup>325</sup> Ministry of Foreign Affairs of Japan, "Signing of the Japan-China-Korea Trilateral Investment Agreement," accessed December 18, 2014, [http://www.mofa.go.jp/announce/announce/2012/5/0513\\_01.html](http://www.mofa.go.jp/announce/announce/2012/5/0513_01.html).

<sup>326</sup> James J. Przystup, "40th Anniversary: Fuggetaboutit!," *Comparative Connections* 14, no. 3 (January 2013): 3.

<sup>327</sup> Ibid., 5.

<sup>328</sup> Meetings listed by MoFA of Japan, "Japan-China Relations."

<sup>329</sup> "Japan and China: Edging Closer," *The Economist*, October 4, 2014, <http://www.economist.com/news/asia/21621892-wholl-bet-meeting-soon-between-leaders-china-and-japan-edging-closer>.

<sup>330</sup> Sheila A. Smith, "Japan and China Get to Yes on an Abe-Xi Summit," *Council on Foreign Relations - Asia Unbound*, accessed December 19, 2014, <http://blogs.cfr.org/asia/2014/11/07/japan-and-china-get-to-yes-on-an-abe-xi-summit/>.

## (2) 2012 Business-to-State Relationship

The 2012 breakdown in China-Japan relations witnessed Chinese and Japanese business groups that were much more involved in changing the tone of the political rhetoric than in either 2005 or 2010. Despite a slew of China-Japan business conventions being cancelled immediately after the events of September 2012, the *Keidanren* led a charm offensive in early 2013 and sustained its momentum leading up to the September 2014 Qingdao rapprochement. In February 2013, *Keidanren* led a business delegation to Beijing and met with former veteran foreign ministry officials in Beijing.<sup>331</sup> The following July, *Keidanren* led another business delegation to China and met with members of the CCP Standing Committee. This meeting was followed by public remarks on China's Central Television by Yu Zhengsheng, fourth ranked member in the CCP Standing Committee, that China-Japan relations needed to be stabilized.<sup>332</sup>

In September 2013, a *Keidanren* delegation visited China and met with retired influential members of the CCP in Beijing.<sup>333</sup> Also in September, there was a reciprocal visit by Chinese business leaders to meet with officials in Tokyo.<sup>334</sup> By November 2013, *Keidanren* were now able to meet with high ranking CCP politicians in Beijing, namely Deputy Premier Wang Yang.<sup>335</sup> *Keidanren* and other business groups in Japan also began to pressure the Japanese government in January 2014 to improve bilateral relations in a joint press conference.<sup>336</sup> In April 2014, Chinese and Japanese business leaders met publicly in Tokyo to signal that economic cooperation between the two nations were still alive and well.<sup>337</sup>

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<sup>331</sup> James J. Przystup, "Treading Troubled Waters," *Comparative Connections* 15, no. 1 (May 2013): 5.

<sup>332</sup> James J. Przystup, "Going Nowhere Slowly," *Comparative Connections* 15, no. 2 (September 2013): 12.

<sup>333</sup> James J. Przystup, "Can We Talk?," *Comparative Connections* 15, no. 3 (January 2014): 8.

<sup>334</sup> *Ibid.*

<sup>335</sup> "Chairman Yonekura's Comments at His Press Conference," *Keidanren*, November 11, 2013, <http://www.keidanren.or.jp/en/speech/kaiken/2013/1111.html>.

<sup>336</sup> James J. Przystup, "Past as Prologue," *Comparative Connections* 16, no. 1 (May 2014): 11.

<sup>337</sup> *Ibid.*, 13.

On September 22, 2014, one day prior to the official state-state Qingdao meeting, a *Keidanren* delegation was sent to meet with either President Xi Jinping or Premier Li Keqiang in a similar fashion as when it had met with Premier Wen and President Hu in 2005. Yet, the delegations was only able to meet again with Deputy Premier Yang as it had the previous year.<sup>338</sup> The inability of *Keidanren* to meet with executive level decision makers in China during high tensions is a noticeable difference.

### (3) 2012 Summary of Evidence

Despite the long lead time up to the Xi-Abe handshake, both relationships performed effectively. As compared to the other years, state to state links took more time to coalesce on the track one executive level. Yet, lower level ministerial and trilateral diplomacy with South Korea continued from 2012 to 2014 on issues concerning investment and trade. Business to state relationship operated more intensely and repetitively during this time as opposed to 2005. *Keidanren* executives, however, were still unable to meet with either the Chinese President or Premier.

### *d. Summary of 2005, 2010, and 2012 Evidence and Analysis*

Overall, Sino-Japanese relations are able to remain stable despite historical-political flare-ups and do not act as a drag force on the trilateral FTA. Yet, the influence of the *Keidanren* on Chinese decision making has changed over the years. While still being able to meet with the Chinese Deputy Premier, the *Keidanren* have lost direct access to the Chinese President and Premier. The inability of the *Keidanren* to have such access might be why the business group so publicly lobbied on behalf of a Sino-Japanese cooperative relationship in the last political upheaval as opposed to its low key approach in 2005.

## **C. FINAL ANALYSIS AND CONCLUSION**

The change in opinion by the PRC that the China-Japan-South Korea FTA is not an economic priority is the strongest explanation for a lack of progress toward the

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<sup>338</sup> See “Chairman Sakakibara’s Statements and Comments at His Press Conference,” *Keidanren*, September 29, 2014, <http://www.keidanren.or.jp/en/speech/kaiken/2014/0929.html>.

trilateral FTA. Essentially, neither CASS nor MOFCOM see the trilateral FTA as being any more significant in terms of being a priority as any other Chinese bilateral FTA. Given that Chinese FTA policy seeks to create both economically and politically competitive mega-FTAs vis-à-vis recent American efforts in regard to TPP, RCEP—and the recently announced proposals for FTAAP—provides for such needs, while the trilateral FTA has lost such economic utility in the eyes of CASS and MOFCOM.

Of the other three potential explanations, the second explanation of SOE interests slowing the progress of the trilateral FTA does not have adequate evidence. SOE interest and influence seems to have been effectively controlled by the PRC in that the CCP decides which SOE sector gets protection rather than the other way around. Additionally, SOE interests slowing the FTA is contingent on the final configuration of the China-Japan-South Korea FTA–WTO-plus or not WTO plus agreement.

As far as the PRC being concerned about domestic competition by Japanese and South Korea TNCs, the evidence suggests that the PRC has an open mind. The China-South Korea FTA has shown that China is willing to open certain state-dominated sectors to foreign competition. This willingness may have even wider implications concerning Chinese plans to move the economy away from export-oriented growth toward endogenous domestic-demand growth by facilitating the creation of efficient, competitive, and profitable industrial sectors.

The most surprising lack of evidence is the fourth explanation, that historical-political animosities cause a lack of progress toward a trilateral FTA. Although, taken in context with observations from Japanese TNCs operating in China that do not see such animosities as affecting their bottom line in Chapter III, the ability of Japanese business groups to liaison with CCP officials and the willingness of such CCP officials to meet with those groups to help reduce tensions make sense. Neither side wishes to disrupt the goose that has laid the East Asian golden egg of trade in value added goods as detailed in Chapter II. Despite historical divisions, Sino-Japanese relations will continue with *zhengleng jingre*.

Overall, the shifting Chinese perceptions of the benefits of the China-Japan-South Korea FTA have affected the lack of progress on the Chinese side of the negotiating table. As detailed above, the Chinese are willing to open certain sectors otherwise off-limits and are not pre-occupied by economic-nationalist sentiments when it comes to the value-added trade system that has developed between China and Japan.

## **VI. CONCLUSION**

### **A. INTRODUCTION**

This chapter provides a summary of the main explanations for the China-Japan-South Korea FTA's lack of progress and illustrates the regional security implications of the trilateral FTA. Overall, Japan is the least willing participant to push for progress toward a trilateral FTA. Japan as well as China perceive the trilateral FTA as not an economic priority. The explanation that best accounts for a lack of progress on the South Korean side of the negotiating table is that South Korea currently views historical and political animosities as a roadblock for further economic relations with Japan. The security implications of a lack of progress toward the China-Japan-South Korea should not be misconstrued as a breakdown in NEA relations—specifically between China and Japan—that could slide into conflict. Instead, the lack of progress is indicative of the hemming and hawing of these regional actors coming to grips with who leads economic integration and how one defines a high quality FTA in the Asia-Pacific. In addition, greater NEA regionalism that could be created by the trilateral FTA will not necessarily diminish the role and influence of the U.S. in the region.

### **B. MAIN EXPLANATIONS**

The research question this study addressed is: what explains the limited progress toward a China-Japan-South Korea FTA? In doing so, various factors that influence the trilateral relationship between China, Japan, and South Korea were considered. These factors included international, regional, state, and domestic levels of analysis. Everything from global trade liberalization through the WTO, regional economic and political venues for cooperation, the presence of other regional FTAs, transnational business operations, regional competition, domestic politics, and national animosities have had a hand in influencing the trajectory of the China-Japan-South Korea FTA.

In order to address the research question and consider all of these factor influences, this study created four potential explanations for a lack of progress toward a

China-Japan-South Korea FTA. The first potential explanation assessed whether or not each country perceived a trilateral FTA as an economic priority. The second potential explanation assessed whether or not influential domestic business interests were hurt by a China-Japan-South Korea FTA. The third potential explanation explored if China, Japan, and South Korea were motivated by relative gains. Finally, the fourth potential explanation assessed the influence of China-Japan-South Korea antagonisms in politics, history, and security on the prospects of the trilateral FTA. The strength of evidence for each of these explanations for each of the countries is summarized in Table 2.

Table 2. Strength of Evidence for Explanation

	<b>Explanation 1: Economic Priority</b>	<b>Explanation 2: Domestic Interests</b>	<b>Explanation 3: Market Competition</b>	<b>Explanation 4: Historical and Political Animosities</b>
<b>China</b>	strong	weak	neutral	weak
<b>Japan</b>	strong	weak	weak	weak
<b>South Korea</b>	neutral	weak	weak	strong

The two main explanations that this study assesses as primarily contributing to a lack of progress in reaching a trilateral FTA are of these countries not perceiving the trilateral FTA as an economic priority, and that regional antagonism prevent further trilateral economic cooperation. Specifically, Japan and China do not perceive the trilateral FTA as an economic priority when compared to the other mega-FTAs of TPP and RCEP. For Japan, TPP takes priority for Japanese economic interest due to TPP's promised WTO-plus standards that assist Abe's goal of achieving the third arrow of structural reform. For China, RCEP takes priority as balance to TPP. For South Korea, political and historical antagonisms permeate the bilateral relationship with Japan. Anti-Japanese South Korean public opinion is mirrored in positions taken by South Korean businesses and the South Korean government.

Of the three countries negotiating the trilateral FTA, Japan seems to be the primary actor for slowing progress. As discussed in Chapter II, Japan gains the least in terms of absolute welfare gains and efficiency gains relative to China and South Korea. The scope and quality of the FTA affects Japan more than China and South Korea. A



trilateral FTA that is not a WTO-plus agreement perpetuates Japan's negative trade balance with China. Additionally, when comparing the economic gains of a trilateral FTA that does not reduce NTBs as compared to the TPP that has a stated aim of reducing NTBs, Japan stands to gain the most with a high quality TPP vice a trilateral FTA that currently does not guarantee complete tariff elimination.

### **C. REGIONAL SECURITY IMPLICATIONS FOR CHINA, JAPAN, AND SOUTH KOREA**

The progress of the China-Japan-South Korea FTA is significant in terms of regional security implications because the trilateral FTA serves as a barometer for regional cooperation. The ability of China, Japan, and South Korea to come to agreements—both political and economic—add to the stability of the not just Northeast Asia but also all of the Asia-Pacific. When a political-economic arrangement such as the trilateral FTA seems to stall after a period of rapid progress, one should step back and assess the underlying reasons. These underlying reasons could indicate that previously assumed patterns of economic interdependence in Northeast Asia have plateaued or are beginning to breakdown. Due to the hub-and-spoke alliance system between the U.S., Japan, and South Korea that provides stability, the focus should be placed on the China-Japan bilateral relationship. Of concern is that the lack of progress toward the trilateral FTA indicates the end of warm economics in the warm economic-cold politics relationship between China and Japan.

Interdependence theorists predict that the economic interdependence of China and Japan will be followed by more politically peaceful cooperation. According to John Oneal and Bruce Russett, "Countries that are interdependent bilaterally or economically open to the global economy, whether democratic or not, have an important basis for pacific relations and conflict resolution."<sup>339</sup> In other words, sunk costs in one another's economies will make such countries averse to conflict. Continuing interdependence can lead to complex interdependence that consists of multiple channels and an absence of a

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<sup>339</sup> John R. Oneal and Bruce Russett, *Triangulating Peace: Democracy, Interdependence, and International Organizations* (New York: W. W. Norton & Company, 2000), 155.

hierarchy of issues.<sup>340</sup> These two factors combined create conditions that reduce the probability of the use of force to solve conflicts.<sup>341</sup> Multiple channels implies that the state is not the only actor, but rather sub-state entities such as bureaucracies, individual government officials, NGOs, and TNCs can create dense networks.<sup>342</sup> Multiple hierarchy of issues ensures that no one issue can paralyze the flows of interdependence between states.<sup>343</sup> Complex interdependence leads states to become enmeshed in a series of sensitivity and vulnerability interdependencies that constrain aggressive behavior.<sup>344</sup>

Recently, concerns have been raised questioning the current state of economic interdependence between China and Japan.<sup>345</sup> Primarily looking at trends in Japanese FDI to China as a leading indicator, there has been a falloff in investment between the two countries.<sup>346</sup> Similarly, the value of total Chinese exports to Japan has flat-lined as well as the value of total Japanese exports to China has markedly dropped since 2011.<sup>347</sup> The fear is that the cold relations between China and Japan since 2012 have had a negative effect on bilateral trade and investment, a proposition working in the opposite direction of that hypothesized by complex interdependence. Quoting Samuel Huntington, *Forbes* columnist Gordon Chang warns that the weakening of Sino-Japanese economic interdependence is akin to the political-economic situation of the 1930s, and such a situation “can be ‘war-inducing’ instead of ‘peace-inducing’ if ‘states do not expect high levels of interdependence to continue.’”<sup>348</sup>

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<sup>340</sup> Robert O. Keohane and Joseph S. Nye, *Power & Interdependence*, 4 edition (Boston: Pearson, 2011), 20–1.

<sup>341</sup> Ibid.

<sup>342</sup> Ibid., 21.

<sup>343</sup> Ibid., 22, 240–2.

<sup>344</sup> Ibid., 232–3.

<sup>345</sup> Takashi Sekiyama, “The Economics of Rapprochement: Can Japan and China Bury the Hatchet?,” *The Tokyo Foundation*, October 16, 2014, <http://www.tokyofoundation.org/en/articles/2014/economics-of-rapprochement>.

<sup>346</sup> Investment trends derived from the World Bank, UNTACD, and JETRO.

<sup>347</sup> Export trends derived from the World Bank, UNTACD, and JETRO.

<sup>348</sup> Quoted in Gordon G. Chang, “The Chinese And Japanese Economies Are Delinking: Prelude To Conflict?,” *Forbes*, February 16, 2014, <http://www.forbes.com/sites/gordonchang/2014/02/16/the-chinese-and-japanese-economies-are-delinking-prelude-to-conflict/>.

The reply to these concerns over weakening Sino-Japanese economic interdependence as being similar to the situation of the 1930 is like comparing apples to oranges. The world economy before both World Wars was not fundamentally the same liberal trade regime that exists today.<sup>349</sup> This speaks to a normative glue between China and Japan that is instilled by a liberal institutional underpinning.<sup>350</sup> Specifically, the WTO architecture provides China and Japan with self-satisfying interdependencies based on the current liberal trade system that incentivizes participation in factor-driven production links to feed a globalized economy. Rather than promote protectionism and retrenchment, certain economic sectors in China and Japan should be incentivized to lobby for greater trade and investment so as to increase efficiency and profit.<sup>351</sup> This has allowed certain actors, such as the *Keidanren* in Japan, to have disproportionate influence on decision makers and policy.<sup>352</sup>

The slowdown in China-Japan-South Korea FTA negotiations has more to do with each of these countries' views on how the WTO architecture—specifically that of the Doha Round—should be applied to Northeast Asia. For the Japanese, large regional FTA's in the Asia-Pacific should be WTO-plus agreements, whereas the Chinese and South Koreans take a pick-and-choose approach to WTO-plus provisions. As noted in Chapter V, the PRC has shifted its opinion from being overtly negative to cautiously accepting of TPP as some Chinese scholars perceive economic utility in TPP's WTO-plus provisions. The lack of progress toward a China-Japan-South Korea FTA is more indicative of a division of opinion, then it is of a fundamental breakdown in the economic relationships of Northeast Asia.

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<sup>349</sup> Patrick J. McDonald, "Peace through Trade or Free Trade?," *The Journal of Conflict Resolution* 48, no. 4 (August 1, 2004): 547–72, doi:10.1177/0022002704266117.

<sup>350</sup> G. John Ikenberry, "The Rise of China, the United States, and the Future of the Liberal International Order," in *Tangled Titans: The United States and China*, ed. David Shambaugh, 1st edition (Lanham, Md: Rowman & Littlefield Publishers, 2012), 54.

<sup>351</sup> McDonald, "Peace through Trade or Free Trade?"

<sup>352</sup> Guoyou Song and Wen Jin Yuan, "China's Free Trade Agreement Strategies," *The Washington Quarterly* 35, no. 4 (October 2012): 116, doi:10.1080/0163660X.2012.726425.

#### **D. REGIONAL SECURITY IMPLICATIONS FOR THE UNITED STATES**

The question for the United States' role and interest in Northeast Asia is whether or not the trilateral FTA diminishes American influence in Northeast and East Asia over the long run. This section will briefly review how the U.S. has played an ambiguous role in regard to creating greater NEA regionalism by China, Japan, and South Korea as well as the potential impact to the U.S. role in the region of a successful or failed China-Japan-South Korea FTA.

The U.S. has had an ambiguous role in regard to NEA regionalism. While not publically speaking against NEA regionalism, the U.S. has blocked some regional specific institutions that were developed by Japan and China. In 1997, Japan announced its intention to create an Asian Monetary Fund (AMF) in response to the Asian Financial Crisis (AFC). Along with China, the U.S. undermined Japanese attempts to create the AMF and successfully ensured the institution was scuttled.<sup>353</sup> Recently, the U.S. and Japan opposed joining the Chinese Asian Investment Infrastructure Bank (AIIB).<sup>354</sup> While the AMF and AIIB are monetary and investment institutions, they are examples of NEA efforts toward creating greater regionalism due to inadequacies in the current global liberal trade order of the U.S.-led Bretton Woods system. Similarly, the impetus of the China-Japan-South Korea FTA was a reaction to the failure of the WTO, an intrinsic part of the global liberal trade order. In regard to American interests in the region, institutions such as the AMF and AIIB are perceived as diminishing the influence of the American-led Bretton-Woods system in East Asia.

In regard to the China-Japan-South Korea FTA, a successful trilateral FTA could not necessarily be in the U.S. best interest in Northeast Asia. Such an exclusive agreement among these NEA actors could possibly diminish the role and influence of American power in the region, especially in regard to growing Chinese influence in the region. As Cheng-Chwee Kuik—a researcher at National University of Malaysia Strategic Studies program—observes that due to the “importance of China to virtually all

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<sup>353</sup> Ye, “The Rise of China and East Asian Regionalism,” 253.

<sup>354</sup> “Japan and the U.S. Stay Out of AIIB; Taiwan Wants In,” *China Digital Times (CDT)*, March 31, 2015, <http://chinadigitaltimes.net/2015/03/japan-and-the-u-s-stay-out-of-aiib-taiwan-wants-in/>.

U.S. allies and partners, it is not unthinkable that an increasingly closer intra-Asian collaboration might over time erode the very foundations of U.S.-Asia ties.”<sup>355</sup> For Japan and South Korea, enhanced cooperation and stability could reduce the utility of the U.S. hub-and-spoke alliance system in East Asia. A successful trilateral FTA could provide Japan and South Korea with a sense of assurance regarding Chinese foreign policy, which is often seen as aggressive. Essentially, a trilateral FTA could change the regional environment so as to allow China, Japan, and South Korea to reassess their interests vis-à-vis the role of the U.S. in East Asia. The cold politics in the region in which the U.S. has played a mediating role could change into a more benign environment that could lead China, Japan, and South Korea to identify their self-interests as not requiring the current level of American involvement in the region.

Not concluding a trilateral FTA can potentially serve U.S. interests by maintaining American influence and power in the region. A stalemate in NEA regional economic cooperation maintains the status-quo in East Asia in which the U.S. plays a pivotal role as both an economic and security provider. This status-quo is a form of hedging and balancing by Japan and South Korea in regard to Chinese military power and foreign policy due to a perception of mistrust.<sup>356</sup> For the Japanese, China is to be balanced against by a policy combination of “dynamic defense” and “dynamic deterrence.”<sup>357</sup> For the South Koreans, the influence and power of China is hedged by “Seoul’s calculated strategic ambiguity.”<sup>358</sup> These policies are backstopped by the hub-and-spoke alliance system that binds Japan and South Korea to America. The status-quo also compels China to accept American involvement in the region as a mediating force between itself and its NEA neighbors. While the Chinese may decry American influence

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<sup>355</sup> Kuik Cheng-Chwee, “An Emerging 3rd Pillar in Asian Architecture? AIIB and Other China-Led Initiatives,” *East-West Center Asia Pacific Bulletin* 305 (March 26, 2015): 2.

<sup>356</sup> Chung, “East Asia Responds to the Rise of China.”

<sup>357</sup> Jimbo, “The Rise of China and Japan’s Foreign Policy Reorientation,” 259.

<sup>358</sup> Chung, “Korean Views of Korea-China Relations,” 221.

in the region as a holdover from the Cold War, they do not deny that the American presence has utility in ensuring a peaceful environment for China.<sup>359</sup>

Overall, it is more likely that the status-quo will remain regardless of the success or failure of the China-Japan-South Korea FTA. Regional competition between China and Japan will continue as well as regional insecurity created by the opaque nature of China's foreign policy and Chinese military modernization in its near-abroad. While not seeking to exacerbate regional tensions, the U.S. policy of ambiguity toward NEA regionalism will continue to serve as a moderating influence in the region.

## **E. CONCLUSION**

The China-Japan-South Korea FTA will continue to be slow rolled by its participants until all sides can come to a fundamental agreement as to whether or not WTO-plus FTAs are the norm or the exception in the Asia-Pacific. While negative public opinion and rhetoric concerning historical and political grievances can seem to suck the oxygen out of the region, the ability of such grievances to affect the economic relations of Northeast Asia are temporally ephemeral. In addition, one should be cautious in misdiagnosing the lack of progress toward a trilateral FTA as indicating a breakdown in the bottom-up and ad-hoc trade relations that have stitched Northeast Asia together. In regard to American interests, the success or failure of the China-Japan-South Korea FTA will have little influence on the regional forces that create a perception of mistrust, which in turn maintain the utility of the American role in the region.

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<sup>359</sup> Yuan, "Awaiting the Handshake: China-U.S. Relations Are the Key to Stability in Northeast Asia."

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